No. 9809

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

NELSON TAYLOR, J. R. MASON, GILBERT MOODY, and N. O. BOWMAN, *Appellants,* vs. PROVIDENT IRRIGATION DISTRICT, *Appellee.*	

APPELLANTS' OPENING BRIEF.

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Appellants,

vs.

Provident Irrigation District,
Appellee.

APPELLANTS' OPENING BRIEF.

JURISDICTIONAL FACTS AND PLEADINGS.

This proceeding is a petition for composition of debts of the Provident Irrigation District, an irrigation district organized under the provisions of "the California Irrigation District Act", of the State of California, approved March 31, 1897, and acts amendatory thereof. The proceeding is authorized under the provisions of Chapter IX of the Bankruptcy Act of 1898. (11 U. S. C. Sections 401-404.)

The jurisdiction of this Court in this appeal is under Sections 24 and 25 of the Bankruptcy Act of 1898 as amended June 22, 1938.

The petitioner herein (Appellee) filed its Petition for Confirmation of Composition in the District Court May 29, 1940. (Tr. pp. 1, 23.)

The Appellants who are creditors of Provident Irrigation District filed their Answer and Objections to the Petition September 3, 1940 (Tr. pp. 29, 40), and in due course filed their proofs of claim (Tr. pp. 40, 42, 50, 194, 197) and on November 14, 1940, filed an Amendment to the Answer and Objections. (Tr. pp. 44, 48.)

The petition was heard November 18, 1940 (Tr. p. 57) and confirmed January 21, 1941. "Findings of Fact, Conclusions of Law and Interlocutory Decree" were filed January 21, 1941. (Tr. pp. 200, 210, 211.) Notice of the entry of the decree was given January 23, 1941. Appellants filed their Notice of Appeal February 21, 1941 from the Interlocutory Decree.

STATEMENT OF THE CASE.

Throughout this brief the Provident Irrigation District will be referred to as the "district" and the Appellants who were respondents below will be referred to as "Appellants". The Reconstruction Finance Corporation will be referred to as the "R. F. C."

The district is located in the counties of Glenn and Colusa in the Northern District of California, and comprises approximately 22,805 acres of land. In its petition the district alleges that it comprises 12,881.27 acres of land.[1]

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1. See Bulletin 21, State of California, Department of Public Works, Reports of Division of Engineering and Irrigation, page 89. The Court will take judicial knowledge of the organization and area of public corporations. A brief history of this district is found in Bulletin 21, commencing at page 89. The same area is reported in Bulletin 21 (i), which is a report on irrigation districts in California for the year 1937, issued by the State of California, Department of Public Works, Division of Water Resources.

The district's principal witness stated (Tr. p. 100) that in 1936 the area was 22,805 acres of land. He then said that under "reorganization" 9924.25 acres were excluded from the boundaries of the district. However, by such exclusion under the provisions of Sections 74-84 of the California Irrigation District Act (Cal. Stat. 1897, p. 254, amended) lands of a district cannot be released from the obligation of the bonds without the specific consent of all the bondholders.

The district, in 1918, issued a first issue of bonds in the amount of $1,000,000, and in 1921 a second issue of bonds in the amount of $190,000, all of which bonds bear interest at 6% per annum, evidenced by coupons attached to the respective bonds payable semi-annually on the 1st day of January and the 1st day of July of each year. (Tr. pp. 2, 3.)

The present outstanding and unpaid indebtedness of the district is the total principal amount of $957,000 of said two issues, of which bonds in the total principal amount of $341,000 have matured and not been paid. Interest coupons in the amount of $415,192.50 have matured and not been paid (Tr. pp. 3, 4), as alleged in the petition.

The total outstanding indebtedness of the district is $1,400,672.50. The district applied to the R. F. C. for a loan and on December 20, 1939 was granted a loan in the amount of $193,500. (Tr. pp. 71, 76.) The terms of this loan provided that disbursements could be made on the deposited securities at the rate of 20¢ for each dollar of unpaid principal amount of the old securi-

ties deposited. (Tr. p. 73.) Deductions were to be made for missing coupons maturing on or before August 15, 1939, at the rate of 12.27¢ for each dollar of the face amount thereof. This in effect provided $200 for each bond with the accompanying coupons. The loan contained certain special conditions. One was that the district was to arrange to reduce the size of the district to approximately 13,000 acres. The second was that the district was to discharge the lien of overlapping drainage indebtedness and to "settle" *ad valorem* (county) taxes on 11,294.49 acres of land owned by the district and apply surplus funds on hand at the date of disbursement and all subsequent income from the sale of land to the reduction of the indebtedness due the R. F. C. ($193,500 maximum indebtedness), except as otherwise provided for by the Division Chief. (Tr. pp. 73-75.) Pursuant to the provisions of this loan, which was granted, the R. F. C. at the time of the hearing had acquired the major portion of the securities of the district.

The plan of composition.

The plan of composition is stated in a resolution of the Board of Directors of the district attached to the petition, and found at Tr. pp. 11-18. The resolution recites the granting of the loan of $193,500 (Tr. p. 13), refinancing the indebtedness by the payment of 20 cents for each dollar of indebtedness "exclusive of interest". The resolution then recites that the Board of Directors has adopted a resolution excluding certain lands from the boundaries of the district and reducing the size to 12,881.27 acres. (Here be it noted one

of the points contended is that this district was not shown to be authorized by law to exclude this area, it not being shown to have followed the procedure prescribed in Sections 74 to 84 of "the California Irrigation District Act".) The resolution then recites that whereas, only a portion of the outstanding coupons maturing prior to January 1, 1931 have been paid in full (Tr. p. 14), the plan of composition is adopted as follows (Tr. p. 15):

> "*That the outstanding indebtedness—in the principal amount of $957,000 and all unpaid interest* accrued and to accrue thereon, be retired by the payment to the respective holders of said bonds of amounts equal to 20¢ for each dollar of principal—provided that all unpaid interest coupons maturing on or after July 1, 1931, are delivered with said bonds * * *"

and then provided for a deduction from the amount paid for coupons that are missing between July 1, 1931, and August 15, 1939, at the rate of 12.27¢ per each dollar and the full amount of coupons missing thereafter. The plan then provided:

> "* * * that for each coupon maturing on or prior to the first day of January, 1931 that may be surrendered or deposited in accordance with this plan, the depositor thereof shall receive the full face value thereof."

The payments of principal were to be made from the R. F. C. loan and the payment of coupons were to be made from funds of the district. (Tr. p. 16.)

In effect, this plan provided $200 for each bond with coupons due July 1, 1931 and subsequently, to be

paid out of the R. F. C. loan, plus the full face amount of any coupons due prior thereto.

It will be noted that in effect the plan provides the payment in full of all obligations of the $1,190,000 bonds of the district maturing prior to July 1, 1931, except the claim of Appellant Nelson Taylor, whose $3000 of bonds due in 1930 are left unpaid by the plan except for the $200 per bond provided by the plan (and even those are paid $230 per bond).

An examination of the acceptances (Tr. pp. 59-67) discloses no acceptance filed in the proceedings on behalf of holders of January 1, 1931 coupons. None of the acceptances filed in the proceedings showed that any of the acceptors owned the January 1, 1931 coupon. Not even the R. F. C. claims to hold these valuable January 1, 1931 coupons. (Tr. p. 49.)

The claim of the R. F. C. is set forth at Tr. p. 49. It shows that the R. F. C. holds $901,000 principal amount of bonds of the district. It therefore holds more than ⅔ of the principal of bonded indebtedness, but it does not claim to own any of the coupons No. 25 which were payable January 1, 1931. The mystery is who holds these coupons? This question bears on the question of good faith, and also upon the question of consent.

The district had taken title to practically all of the land and held this title for a long period of time.

SUMMARY OF THE TESTIMONY.

The appellants will briefly summarize all the testimony, both oral and documentary.

Summary of exhibits in evidence.

Petitioner's Exhibits.

Petitioner's Exhibit 1 (Tr. p. 70) was a resolution of the R. F. C. granting a loan of $193,500 to the district.

Petitioner's Exhibit 4 (Tr. p. 59) was the form of the acceptance of the creditors of the district of the plan of composition, together with a statement of the creditors accepting. No point is made as to the form of the acceptance nor that there was any failure as to the numerical requirement of acceptance, so far as the principal of the indebtedness is concerned. There is no acceptance evidenced, however, as to the coupon number 25 due January 1, 1931, which is paid in full by the plan.

Attention also is called to the fact that none of the claims evidenced or put in as acceptors show any bonds maturing prior to July 1, 1931. (Tr. p. 67.)

Petitioner's Exhibit No. 5 (Tr. p. 141) was a resolution of the Board of Directors of the district accepting the R. F. C. loan.

Petitioner's Exhibit No. 6 was a resolution of the Board of Directors authorizing the proceedings in the bankruptcy Court. (Tr. p. 144.)

Petitioner's Exhibits No. 7 (Tr. p. 146) and 8 (Tr. p. 165) were minutes of the Board of Directors show-

ing the canvassing of returns for the bond election for the issuance of Refunding Bonds to be delivered to the R. F. C. and evidencing the approval of the California District Securities Commission approving the issuance of the Refunding Bonds and certifying that the commission finds and determines "that the amount of the refunding bonds to be issued together with all other outstanding bonds of the district, including bonds authorized but not sold, does not exceed sixty (60) per centum of the aggregate value of the water, water rights, canals, reservoirs, reservoir sites, irrigation works and other property owned by the district and the reasonable value of the lands within the boundaries of the district and that said project is economically sound and feasible;". (Tr. p. 151.)

Attention is called to the fact that no exhibits of any character were introduced into evidence by the petitioner district showing the assets of the district, showing any balance sheet, any crop returns of the district or containing any financial statement of the affairs of the district whatsoever.

Appellants' exhibits.

Appellants (respondents below) introduced into evidence three exhibits.

Exhibit A (Tr. p. 118) was a statement of receipts and disbursements for the year ending December 31, 1935, issued by the district. This exhibit was introduced into evidence for the purpose of showing the receipts of assessments, 1930, $1607.17, 1934, $25.65, 1935, $45.00, income from land, $25,071.94; Disburse-

ments: Bonds redeemed, $2000; interest coupons, $3,-120; interest on registered bonds and coupons, $1328.13. These receipts and disbursements were shown in evidence by appellants in connection with the position of Appellant Nelson Taylor holding the only bonds due prior to July, 1931, which have not been paid and which were in fact presented for payment in January, 1931 (and were lawfully entitled to payment before the bankruptcy petition was filed as more fully shown in the argument infra); and showing that funds were received by the district properly applicable to the payment of these three bonds, with accrued interest, and that in fact *in the year 1935* the district actually disbursed in payment of bonds $2000, and in payment of coupons and interest on registered bonds and coupons, $4448.13. (Tr. p. 118.)

Respondents' Exhibit B (Tr. p. 191) was the financial statement of the district for the year ending December 31, 1937 and was introduced for the purpose of showing receipts for assessments for the year 1935, $44.50, year 1936, $138.03, year 1937, $189.54, and income from land in the amount of $23,121.01.

Respondents' Exhibit C (Tr. pp. 194, 196), the claims of the appellants (Tr. pp. 40, 42, 50) also evidenced by their answer which is verified. (Tr. pp. 29, 44.) Particular attention is called to the claim of Nelson Taylor. (Tr. p. 40.) This claim shows him to be the owner of bonds numbers 7, 8 and 9 of the first issue, due August 15, 1930, in the principal amount of $3000, which bonds were presented January 30, 1931, to the treasurer of the district for payment.

Also three interest coupons totalling $22.50 due at the same time. The interest coupons are not payable under the plan although subsequent coupons of all other bonds due January 1, 1931 are so payable and the bonds which were due January 1, 1930 and presented January 30, 1931, are not payable under the plan, although all other bonds due prior to July 1, 1931 have been paid.

It will be hereafter shown by the evidence that the failure of the district officials to pay these bonds when they were due, or as funds became available long before the filing of the bankruptcy petition, was due to the deliberate and unlawful actions of withholding payment based upon its unsupportable contention that the bonds were "outlawed", which action was determined by the California Supreme Court to be untenable in *Moody v. Provident Irrigation District,* 85 Pac. (2d) 128, 12 Cal. (2d) 389. (Nov. 28, 1938.) Also through the same "error" the district improperly paid bonds due subsequently *in place of paying these lawfully payable bonds of Appellant Nelson Taylor.* The Appellants make the point that the *plan of composition should have provided for the payment of Nelson Taylor's claim in full* with accrued interest at 7% as provided by Section 52 of the California Irrigation District Act, and that the District's failure so to provide makes the plan unfair and discriminatory and in bad faith.

The principal amount of the claims of the Appellants evidenced in the record, exclusive of coupons and interest is: Nelson Taylor, $3000; J. R. Mason,

$17,000; Gilbert Moody, $3000; N. O. Bowman, $9000. (Tr. p. 45.)

Oral testimony.

The following witnesses testified:

Charles F. Lambert (Tr. pp. 58-129) the chief witness for the district testified: That he is the fiscal agent for the Provident Irrigation District; he has lived in Willows since 1907; he organized the Glenn-Colusa Irrigation District and the Maxwell Irrigation District. He contacted the "control" of the bondholders which were represented by the Provident Land Corporation and the Provident Bondholders' Committee—50% were controlled by them. He was primarily interested in the litigation that was then brought and being prosecuted by the Provident Land Corporation and the Bondholders Committee against the *Provident Irrigation District,* 12 Cal. (2d) 365.[2] After the decision of the Court in those cases it opened the way for the first time for the Provident Land Corporation and Bondholders Committee to enter into negotiation for refinancing. (Tr. p. 69.) After negotiation an application was submitted to the R. F. C. and in December, 1939, a loan was granted. He then proceeded to contact the bondholders and to obtain deposit of bonds. (Tr. p. 70.)

The County of Glenn and Reclamation District 2047 overlapped all the lands of the Provident Irrigation

2. This litigation which was very extensive and was long before the California Supreme Court was represented in the following suits: *Provident Land Corporation v. Zumwalt, Moody v. Provident Irrigation District, Provident Land Corporation v. Benoit, Provident Land Corporation v. Provident Irr. Dist.,* all in 12 Cal. (2d).

District. Both districts had obtained title to the lands (Tr. p. 99) for the reason of the lands being delinquent more than five years, and the district had acquired title to all but 350 acres of the land. In his opinion the only way the district could be rehabilitated or reorganized was to cast out all the non-agricultural land within the district, and set up a new district, and then find purchasers for the lands in the district, clear the title from the Reclamation District, County and State Taxes. (Tr. p. 99.) The source of money to clear the title was through sale of the land. (Tr. p. 100.) In 1936 before this reorganization was undertaken, the total obligation outside of the district's indebtedness was $652,485.02, covering the 22,805 acres of the district area. Under reorganization 9924.25 acres was excluded from the district, which represented a total obligation for reclamation district and county taxes of $339,972.04, leaving $312,512.98 the outstanding obligation which had to be cleared before the district could perfect its loan obligation to the R. F. C.[3] (Tr. p. 100.) The reason was that 1586.78 acres were owned by individuals. (Tr. p. 101.) At least 70% of the area has been used for pastoral purposes, the balance for growing grain, principally barley. During the rice days of the war days rice became a very high price. After organization the dis-

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3. There is no evidence in the record of any proceedings to exclude this area from the district and the authority of the district to wipe out the obligation of the bonds is absolutely denied under the Stats. of California, California Irrigation Dist. Act, Secs. 74, 84.

Note is also made of the fact that the district is no more justified in paying off obligations of other taxing agencies than of paying off its own indebtedness. See *Anderson-Cottonwood Irrigation Dist. v. Klukkert*, 88 Pac. (2d) 685, 13 Cal. (2d) 191.

trict went into immediate production, giving land owners the high prices of 1919 and 1920. From then on crop results were obvious. The lands were owned by the district, being practically one ownership. For a period of years the lands met their assessments and charges, *until the bond issue of Reclamation District 2047 which overlaps 7 irrigation districts in Sacramento Valley and the lands of the Provident District became due.* "When the land owners only had to pay interest they struggled and made up their losses, keeping their installments intact, but with the falling due of the Reclamation District principal charges the land went into default." During the period 1922 to 1930 the burden pyramided and through failure to farm the land in a farmerlike manner a low crop production was brought about, so that in 1936 the average crop production had hit a low of 19.08 bags of rice per acre. Subsequent to 1936 rice has been up and down in price. Production has fluctuated between 20 and 30 bags, and the witness saw no way of rehabilitation except through adjustment.

The County of Glenn accepted 10 cents on the dollar for their debts. The Reclamation District probably received 35 cents[4] on the dollar for their debt, and the lands were sold at an average price slightly less than $10 per acre, that is the 11,294.49 acres which were left in the district. There were 46 separate land sales. (Tr. p. 104.) Practically all of the lands have been

4. Somebody made a nice profit evidently, because the reclamation bondholders got 42½¢, which the Provident District paid,—whilst only offering its own creditors 20¢. (Tr. p. 103.)

purchased by tenants who have been farming the land in the past. The crops accruing in 1940 are turned back to these buyers for them to use in improving the land. Otherwise I couldn't find buyers at all. As to the 9924.25 acres outside the district,[5] those lands are owned jointly by the district, the reclamation district and the counties. We know of no way of bringing about an adjustment between the county and the reclamation district that will permit these lands to be sold at any price and provide any sum for the irrigation district.[6]

The debt is practically $34 an acre, which is prorated back among the three taxing agencies.[7] The best value we know is that the Interior Department through the Biological Survey intend to condemn this land. (Tr. p. 105.) This is for the Sacramento Valley Wild Fowl Refuge, which they want to purchase for $7 an acre.

Under the rehabilitation plan considerable expenditure has been made and has to be paid by the land owners to improve the canal system. (Tr. p. 107.) Through the R. F. C. plan the bond debt will be an average of $14.50 per acre, in addition to which the

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5. Appellants contend that this land is still subject to the trust in favor of the bonds under the California Irrigation District Act, Secs. 74, 84.

6. See Section 3897 (d) of the Political Code which provides the procedure contrary to the testimony of the witness and which procedure is used extensively in California. The procedure was approved in *South San Joaquin v. Neumiller*, 2 Cal. (2d) 485.

7. The Court will take judicial notice of the fact that it is costing from $75 to $165 an acre to put raw land under irrigation throughout the west, and that thousands of acres are being handled in this manner by the federal government at the present time.

new purchaser paid $10 per acre for the land.[8] A survey shows that out of 13,000 acres 1100 can be used for Ladino clover, 200 for alfalfa. Melons are not grown because of heavy alkali. 6500 acres of the excluded area is 1 to 3% alkali, which puts it out of production. I would say the land could not carry any additional load. The whole plan is all predicated on the last five years basis, in order to strike an average.[9] Of course, cost of production has come down. Machinery and new methods have come in. The best practice would be rice crops every alternate year. We classified the land as follows: 9169 acres Class A, or the best class of rice land; 2715 Class B, 1655 Class C, 96 is D, being practically waste or worthless and sold for $4 for pasture.

At the time the bonds were issued rice was as high as $8.50, and some crops reached $250 an acre. Even the poor land, being virgin land, produced as high as 35 bags. Rice went as low as 60 cents a hundred in 1932 and '33. Rice production can be stepped up by good farming, fertilization. Taking it on a dollar, the 40 sack crop production land owners will be able to meet their charges as they mature, taxes, reclamation assessments, their bond charges under this loan. (Tr. p. 111.) Prices have gone as high as $1.65 per cwt. during the past ten years.

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8. Special condition No. 3 (Tr. p. 75), requires the district to turn in all this money to the R. F. C. At $10 an acre the amount would be over $120,000, which when deducted from $193,500 leaves a meager sum still outstanding. Besides this there is the prospective sale to the Biological Survey of land intended for exclusion from the district.

9. The years 1909-14 are taken by most economists as the typical standard years of agriculture. This is also the basis for stabilization of agriculture prices in recent congressional legislation.

In 1934 the district took title to 6671 acres. In 1937, 6654.02 and prior thereto, in 1929, 54 acres. In 1928, 3089 acres. 1927, 2614 acres. (Tr. p. 112.) By this I mean that the land has been delinquent for three years and that the fourth year the district takes title to it.

There can be no question raised of good faith. (Tr. p. 114.) So far as the creditors are concerned the plan is fair, equitable and for their best interests. The plan does not discriminate unfairly against any of the creditors except this one possible thought that came to me, except the interest on the three bonds represented by Mr. Cook, No. 7, 8, and 9. (Tr. p. 114.) Under the plan of reorganization we picked up and paid all coupons prior to January 1, 1931, for the reason that a portion of the coupons had been paid from January 1 to July 1. So as to equalize it, the balance of the coupons, we paid off coupon holders from our funds, from the R. F. C. money. But these three bonds, as I see it, is the only instance where all bondholders are not receiving the same. (Tr. p. 115.) Those three bonds matured in August, 1930. There are not any earlier bonds that haven't been paid. (Tr. p. 116.) These are the only ones that haven't been paid up to January 1, 1931.

"Mr. Cook. Isn't it true that all bond principals that matured before January 1, 1931, have been paid, except these three bonds?

A. That is correct." (Tr. p. 120.)

We could not pay them because the R. F. C. will pay 20 cents on the dollar. The district picked up this

extra, some $22,000, and then we picked up from the sale of land in order to make up the difference. What I am referring to is the little difference in interest that accrued from August 15th on those bonds, amounting to $67.50.[10]

Mr. Cook. Will you state whether it is true that in the last couple of years there has been some money in the bond funds?

Mr. Freeman (Counsel for district). That is true. There is a sum of money from that Zumwalt assessment. I think it shows it is in the bond fund.

The witness continuing. The average size of the farms sold would be around 400 acres, running as high as 1500 acres. I purchased for my daughter and my son 230 acres of land which was not rice land and which was not saleable because of its roughness. The total amount I received from the district for my services was $20,300 as fiscal agent.

In the case of the purchase of the Spaulding Ranch by the Biological Survey they paid $13.50 an acre. Out of this sale the district received $52,000. That was a stipulated sale and this is a contested sale. When I say the Reclamation District 2047 got relatively 35 cents on the dollar for their bonded debt I am speaking of the bondholders. The bonds were completely cleared up on those lands. The purchasers of the district land buy the title free and clear of Reclamation

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10. The witness appears to refer to the fact that these three bonds matured August 15, 1930 and so had no coupons due January 1, 1931, but only coupons totalling $22.50 due August 15, 1930, a difference of $67.50 since all other bonds have January 1, 1931 coupons of $30 each. Not only are these three bonds alone of all bonds due before July 1, 1931 unpaid, but also the holder is denied the $90 interest payable on any other three bonds.

bonds, except about one-half a month's bond debt of floating warrants. That was accomplished by means of auction sale at the courthouse by the Board of Trustees of the Reclamation District, and the result to the bondholders was about 35 cents on the dollar. The bonds were used to clear the Reclamation assessments on the land. The bondholders furnished their bonds at $42.50, but the price the district paid was 35 cents on the dollar. The land which I myself purchased was the roughest land in the district, and I practically had to purchase it in order to clear up the transaction. I bought it for my son and daughter. It is good pheasant hunting country. There is no tax except the county tax. This land outside the district I don't think the Biological Survey will pay the price of condemnation.

If it isn't sold to the Biological Survey or sold privately taxes can be cleared up at a reduced rate.

Counsel for appellants asked the witness what the district wanted for the land from the Biological Survey. Witness answered that they don't say.

"Q. What is it worth to the district as an asset?

A. Well, now, Mr. Cook, when a district is going to meet condemnation proceedings it is not making any stipulation as to value.

Q. I am asking for the record here.

The Court. Well, now, let us see. We don't want the District, after struggling for twenty years, to have a record here that might stand against it.

Mr. Cook. I wouldn't think they would understate the value.

The Court. Here, it is worth $13.00 according to the contract agreement on account of the conditions and everything. If they are condemned that will be the issue there. Let us say, suppose the District got the best price possible. I say that kindly."

Counsel then pressed the witness for an answer and he said that the land was worth $5.00 an acre, adding "I am not in a position to testify as to what that land is going to be worth without calling attention to the tax burden of half a million dollars".

"Mr. Cook. Q. Let us assume that all the taxes are dissolved.

A. You can't do that."

The witness then said finally that it was worth $5.00 an acre with no tax obligation; that it has no agricultural value and that as to oil interests, they are prospecting all over the state. They hit some gas about several years ago.

H. E. Vogel (Tr. pp. 130-140), was next called as an expert witness for the district, he being an employee of the California District Securities Commission since 1931. He is one of the members of the Commission. After showing his qualifications he read a report that he made to the district. When the bonds were issued the bond debt was $52 an acre. (Tr. p. 132.) There are three resident land owners left in the district, and there are only three holdings that are clear of tax assessments, one of 35 acres, one of 10 acres and one of 20 acres. This report was made in 1933. (Tr. pp. 131-133.) He testified that he did not believe the district could stand in the way of all its obligations

any greater load than $14.50 an acre. This is because the district is not adapted for general crops. The land is shallow, most of it is clay soil and water will not penetrate. (Tr. p. 135.)

He thinks the plan is fair. (Tr. p. 136.) When the Commission meets to pass on the feasibility of a plan there is no hearing[11] held unless somebody actually appears. (Tr. p. 137.)

The law requires the Commission to determine whether the bond issue can be issued and the bond issue does not exceed 60% of the value of what you might call corporate assets—that is, of the land, water rights, irrigation system already constructed or to be constructed. It was his judgment that these bonds did not exceed 60% of the value of those assets. (Tr. p. 138.) (See Cal. Stat. 1931, p. 2263, amended Stat. 1933, p. 355, Stat. 1937, pp. 491, 1426.)

In answer to the question as to why the plan was not unfair because it did not give 100% of the value to the bondholders the witness replied that you cannot borrow from the bank 100% on a piece of property.

It is a fact that these lands, when held by the district, are not subject to county taxes.[12]

T. E. Balch, witness produced by the district (Tr. pp. 171-176), testified: He is the superintendent of the district; the district has somewhere around $22,000

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11. The witness refers to the question asked whether hearings are held on notice to bondholders.

12. In the case of *Anderson-Cottonwood Irrigation Dist. v. Klukkert*, 13 Cal. (2d) 191, 88 Pac. (2d) 685, the Court held that lands thus held by an irrigation district are not subject to taxation by the county so long as so held.

cash on hand. (Tr. p. 173.) That at $14.50 an acre, it will still be hard to get along. As to the price of rice, several sold rice the other day and the buyer offered $1.30 for 44 head warehouse rice.

In rice crops, if they take one crop and summer fallow the land and plant their grain the third crop, these fellows are really making a lot of money. But if they farm it two out of three they are just struggling along. The usual practice is to farm just half of their land each year to rice. Under the system of allotment by the Department of Agriculture, with the low price of rice, they barely make expenses, and the bonuses are the only thing they have to live on—that is, the benefit payments. There is no other way I know of to pay these bondholders any greater sums of money. I would say the plan is remarkably fair. The cost in the average year of farming land for rice is $33 to $37 an acre. The water cost is $5 an acre, which the landowner furnishes. The figures given are for actual costs. One-third of the crop goes to the land-owner, out of which the landowner pays the water and assessment taxes.[13]

George Freeman, counsel for petitioner, took the stand as a witness for the district and testified (Tr. pp. 177-178): After stating what compensation he had received he was cross-examined and said: That in 1936 or thereabouts the district declared a surplus of $10,-

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13. This raises a most unique question. The witness says the "landowner" pays the water cost and assessments out of the ⅓ of the crop going to the landowner. The district is the principal landowner—almost sole landowner. The district is the trustee for the bondholders. (*Provident v. Zumwalt*, 12 Cal. (2d) 365.) The farmer or tenant can pay his own expenses of crop raising from his ⅔ and the district can receive the net from the ⅓.

000 or thereabouts was available in the general fund—that is, the money was in the general fund and they declared a surplus and bought bonds with it at 20 cents on the dollar. Suit was brought by the Provident Land Corporation to set aside the sale, to get the money back into the treasury. That was done and the money was put back in the general fund.[14] Mr. Freeman then stated that the secretary of the district stated that the money from redemption of land went into the bond fund in the approximate amount of $5500 and that it is in the bond fund now and included in the balance which Mr. Balch says was on hand amounting to $22,000.

Mr. Freeman reiterated that the plan provides for payoff of all the January 1, 1931 coupons *without reference to when they were presented.* Counsel for the appellee and for the appellants then agreed (Tr. p. 180) that Section 52 of the California Irrigation District Act and relevant sections provides for the payment as to a solvent district in the order of presentation of the bonds and coupons to the treasurer.

The witness continued and testified that in the plan of composition this rule of order of payment is not applied at all, and that the rule which was adopted in the plan of composition was that the district would pay everything up to and including interest to January, 1931, whenever or wherever presentation was made. (Tr. p. 180.) And that it is a fact that a great

14. This is the case of *Provident Land Corporation v. Zumwalt*, 12 Cal. (2d) 365, upon which appellants rely as being declaratory of the local law and as being the law of the case in this case.

many coupons were presented and have been paid which were presented after Appellant Nelson Taylor's bonds were presented in 1931. (Tr. p. 181.) *The witness also testified that there were other bonds that were due on August 15, 1930, when the bonds of Nelson Taylor were due, which have been paid.* (Tr. p. 181.) Counsel also agreed that some bonds have been cancelled on land transactions since January 1, 1931. The witness then testified (Tr. p. 181): "At the time the position was taken that the bonds that Mr. Taylor now owns, were outlawed, and the two bonds subsequently paid ahead of those." He would not say that Mr. Taylor's bonds were outlawed, but confirmed that they were presented and the reason that the other payments were made was because the district officials concluded they had outlawed and therefore some other bonds should be paid.

Thereupon appellants moved that the plan be amended or that it be approved subject to the payment of the three bonds of Nelson Taylor or subject to the three bonds of Nelson Taylor being left out of the plan to be paid by the district, or that the plan be amended in this respect.

This motion was subsequently denied.

The witness then testified that appellants' counsel had asked the district to amend its plan but the district was leaving it entirely to the Court. The witness then testified: "I think it is true there aren't any bonds that are in the class of those three bonds." (Tr. p. 182.) This matter was discussed somewhat further

by the witness, counsel for appellants and the Court, as will appear from the record, Transcript pages 182-199.

At page 182 of the Transcript it appears that appellants' counsel stated to the Court that he took the position that the Court should authorize payment of those three bonds, as all other bonds due before January 1, 1931 were paid in full and that only through some bookkeeping error or misunderstanding these three were not paid.

The lower Court did not seem to fully understand the situation, for the Court remarked (Tr. p. 185): "Why didn't he get paid, because the coupons were separated from the bonds?" indicating that the Court did not understand what the real situation was. Counsel for the district thereupon stated: "I wouldn't take it that the district wouldn't just pay, the district couldn't pay at the time Mr. Cook called attention to the two bonds. It had not then been established as to the outlawing period, and the position was taken that these bonds could not be paid until it was proved they were not outlawed, * * *"[15]

The Court's next remark (Tr. p. 185) that the money wasn't there when Taylor went to get it, in-

15. In the case of *Moody v. Provident Irrigation District*, 85 Pac. (2d) 128, 96 Cal. Dec. 512, 12 Cal. (2d) 389, decided November 28, 1938, it was definitely established that a bond which has been presented for payment as these bonds had been (Jan. 30, 1931 these bonds were presented for payment as shown supra) does not outlaw until the district has funds on hand and has given notice of payment to the bondholders. The witness had just finished saying that there was a surplus of $10,000 as the basis of the suit of *Provident Land Corporation v. Zumwalt*, and also $5500 in redemption money.

dicates that the Court did not understand the Moody v. Provident decision, which requires notice to the bondholders, and that money coming in afterwards shall be applied to payment of the bonds previously presented.

At Tr. p. 189 this discussion occurred:

"Mr. Cook. The District admits that except for error on its part these would have been paid.

The Court. *What error was made? If there was an error made, I want to know it.*

Mr. Freeman. *The error that was made, we did pay two bonds that came due after these bonds came due on the theory that these three bonds were outlawed by reason of their nonpresentation.* Now it is only in the last couple of years that the Court determined that the statute of limitations does not run against those bonds,[15] and since that time there has been no money available for their payment. That is the error. Because we didn't have any money until 1939 in the bond fund.

"The Court. How can this Court know whether they should have been paid in 1930 if the showing is that they didn't have the money?

Mr. Cook. The showing is that they had money to pay two other bonds."

Thereupon *Blanche Covert,* Secretary of the district, was called as a witness. (Tr. pp. 193-198.) Whereupon the appellants introduced into evidence their claims (Tr. p. 194 Respondents' Exhibit C) and it was stipulated that the bonds of Nelson Taylor were pre-

sented to the treasurer January, 1931. (Tr. p. 194.) The witness stated that there was a redemption of land in the amount of $5500 made in 1939 that belongs in the bond fund. Also there was a redemption of about 60 acres in 1936. Witness could not recall the payments of assessments in 1930 (that was before her employment as secretary).

The Court then indicated that he would approve the plan (Tr. p. 197):

"The Court. 94% of the bondholders?

Mr. Freeman. 94% plus, yes.

Mr. Cook. The Supreme Court says that doesn't count.

The Court. The Supreme Court does the best it can with disputed situations * * * They do the best they can and my duty here seems to be clear, and for that reason I will confirm the petition."

"Mr. Cook. Might I point out that the plan doesn't allow any compensation for the objecting bondholders?

The Court. If the law did, and I could read that into the law, I could be able to help you.

Mr. Cook. I would like to request a special finding on the question of the three bonds when the findings are filed, on the fact regarding those bonds. Rule 52a provides for special findings."

Thereupon the case was submitted.

APPELLANTS' POINTS.

First Proposition: The plan is unfair and discriminatory as to the creditor, appellant Nelson Taylor, in that it does not provide for payment of his three bonds with accrued interest in full.

Second Proposition: The evidence was insufficient to support the finding of the court that the plan is fair and equitable and for the best interest of the creditors, and the findings do not suport the decree as respects this question.

Third Proposition: The plan of composition is unfair.

Fourth Proposition: The Court erred in failing to follow the local law applicable to this district and which was the law of the case.

Fifth Proposition: The plan of composition is not presented in good faith.

Sixth Proposition: The plan of composition is not supported by local law.

ARGUMENT.*

FIRST PROPOSITION: THE PLAN IS UNFAIR AND DISCRIMINATORY AS TO THE CREDITOR, APPELLANT NELSON TAYLOR, IN THAT IT DOES NOT PROVIDE FOR PAYMENT OF HIS THREE BONDS WITH ACCRUED INTEREST IN FULL.

Assignment of Errors: 12. The plan of composition discriminates unfairly against Nelson Taylor, appellant. (Tr. p. 216.)

13. The Court erred in confirming the decree as to Nelson Taylor and in not holding that he should

*The foregoing summary of evidence is a necessary part of this argument.

not be made subject to the plan of composition. (Tr. p. 216.)

25. The plan of composition is unfair because it provides for the payment of obligations of the district maturing up to and including January 1, 1931 in full, and does not provide for the payment in full of the bonds of Appellant Nelson Taylor, amounting to $3000, which matured August 15, 1930, and which the district should have paid prior to the filing of its petition in bankruptcy. (Tr. p. 218.)

Nelson Taylor was entitled to separate classification as a creditor. He should never have been made subject to the plan of composition. His $3000 of bonds and the accompanying three coupons and the accumulated interest should have been paid in full.

He moved the Court for an order amending the plan to permit such payment. The motion was denied. (Tr. p. 181.)

Briefly the facts relative to this appellant are these: The three bonds of Nelson Taylor, bonds Numbers 7, 8 and 9, matured August 15, 1930. (Tr. p. 41.) They were presented to the treasurer of the district for payment pursuant to Section 52 of the California Irrigation District Act on January 30, 1931. (Tr. p. 41.) Section 52 of "the California Irrigation District Act", Stat. 1897, p. 254, as amended Stat. 1931, p. 172 provides: "Upon presentation of any matured bond of the district, the treasurer shall pay the same * * *. If money is not available * * * it shall draw interest at the rate of seven per cent per annum from the

date of its presentation for payment until notice is given * * *"

See also Section 61a, same Stat.

The irrigation district law of California plainly provides as to any district that payment to its bond creditors shall be made in the order of presentation. *Bates v. McHenry,* 123 C. A. 81; *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365.

So long as the district was operating as a solvent district it was required to make these payments pursuant to that section. (*Moody v. James Irrigation District,* 114 Fed. (2d) 685, 688.) This district has in fact followed that general principle or policy up to the time of filing its bankruptcy petition. It was recognized by the district's officers as being correct that that procedure should be followed, and in the case of *Provident Land Corporation v. Zumwalt* (supra) the California Supreme Court on November 28, 1938, went so far as to declare that surplus funds of this district "should be paid on past due bonds in the order of their presentation". The only reason that the three bonds of Nelson Taylor were not paid in the order of presentation and that subsequent bonds and coupons were paid was that the district deliberately and unlawfully withheld payment on the asserted theory (Tr. pp. 181, 189) that the bonds had outlawed, and continued that stand until the decision in the case of *Moody v. Provident Irrigation District* in which it was determined that the presentation of bonds to the treasurer prevents the statute of limitations from running until the treasurer has funds and notifies the

bondholders. But even then the district continued its refusal and failure to comply with the law. The district not having money to pay these bonds when they matured, registered them and then subsequently after the four year period paid other bonds that had been presented on the wilfully and oppressively asserted theory that these bonds of Nelson Taylor were outlawed. Thereafter, the district continued to refuse to make payment, although it subsequently paid two other bonds that matured afterwards (Tr. p. 118) and even in its plan of composition provided for payment of all obligations which have matured prior to July 1, 1931, which is subsequent to the date of maturity of Nelson Taylor's bonds, and actually proposes to pay many coupons which were presented to the treasurer afterwards. (Tr. p. 180.) Nelson Taylor was not one of the inside circle of Freeman, Lambert and McKaig, or he would have been paid.

The case of *Provident Land Corporation v. Zumwalt* specifically determined that the funds of this district which consist of surplus funds or were available for creditors should and could only be applied to payment in the order of presentation. Here surely is a declaration of local law which is not only of general character but applies specifically to the facts of this case.

The failure of the district to provide for the payment of these three bonds in full, with accumulated interest, is not only unfair, discriminatory, takes vested rights of the appellant Nelson Taylor but cannot well be in good faith and a court of equity will not give its approval upon a wrong which has been done.

SECOND PROPOSITION: THE EVIDENCE WAS INSUFFICIENT TO SUPPORT THE FINDING OF THE COURT THAT THE PLAN IS FAIR AND EQUITABLE AND FOR THE BEST INTEREST OF THE CREDITORS, AND THE FINDINGS DO NOT SUPPORT THE DECREE AS RESPECTS THIS QUESTION.

Assignment of Errors 8. The evidence adduced at the hearing was insufficient to sustain the petition. (Tr. p. 216.)

17. The Court erred in not finding the facts specially. (Tr. p. 217.)

18. The Court erred in that the findings do not determine what the assets or liabilities of the Provident Irrigation District are while finding that the district is insolvent. (Tr. p. 217.)

All that the findings determine in the way of facts is that the petitioner is insolvent or unable to pay its debts as they mature, that the plan is "fair", that the allegations of the petition are true. (Tr. pp. 201, 202, 1-8.) The question of fairness is a matter of law. Here is no substantial fact found upon which to base a decree.

Because of the somewhat lengthy and detailed statement of the entire evidence set forth above it is considered that it would be somewhat of an imposition on the Court to repeat too much of that evidence. But the foregoing summary of the evidence shows quite clearly that the rules of the case of *Consolidated Rock Products Company v. Dubois,* 61 S. Ct. 675 have been violated. The decision in that case was on certiorari from this Court and involved a corporate reorganiza-

tion under 77b. (11 U. S. C. 207.) Mr. Justice Douglas stated that the case involved questions as to fairness. It is of course obvious that the requirements for consideration of certain indicia of fairness was not a requirement of 77b at all, but the decision resolves itself into the laying down of certain fundamental and general rules for the determination of fairness in corporate reorganization. No more can it be said that those rules are set forth in Sections 81-84 of the bankruptcy Act. Yet the same language is used in both statutes. In Section 77b there is the same requirement as in Sections 81-84 that the petition must state that the corporation is "insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization".

Section 83a (11 U. S. C. 403a) says that the petitioner must state in its petition that it is "insolvent or unable to meet its debts as they mature, that it desires to effect a plan for the composition of its debts".

Section 77b provides that "a plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally or of any class of them, secured or unsecured, either by the issuance of new securities of any character, or otherwise". And a like provision as to stockholders. The Municipal Bankruptcy Act provides that the "plan of composition" within the meaning of this chapter, may include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities or otherwise.

Section 77b provides that "after hearing such objections as may be made to the plan the judge shall confirm the plan if satisfied that (1) it is fair and equitable, does not discriminate unfairly in favor of any class of creditors or stockholders, and is feasible", and also, amongst other things "(6) the offer of the plan and its acceptance are in good faith * * *".

The Municipal Bankruptcy Act provides: "(e) At the conclusion of the hearing the judge shall make written findings of fact and his conclusions of law thereon, and shall enter an interlocutory decree confirming the plan if satisfied that (1) it is fair, equitable and for the best interests of the creditors and does not discriminate unfairly in favor of any creditor or class of creditors;" And after making other provisions comparable to section 77b, also provides that the Court must determine: "(5) The offer of the plan and its acceptance are in good faith;" The essential framework therefore of 77b and of Sections 81-84 of the Bankruptcy Act are identical. The same tests of fairness are applied so far as the statutes are concerned, and it seems logical as a conclusion therefrom that the same yardstick and methods must be applied in reaching a determination of fairness. A foot is twelve inches in any country, and while the question of fairness will vary from case to case, there seems no reason for varying the logical thought and the reasoning by which such conclusions are reached.

Now in the *Rock Products* case the Supreme Court pointed out the absence in the record of certain essential evidence, without which it seemed to the Supreme

Court that no conclusion of fairness could be reached. The Supreme Court said:

> "1. On this record no determination of the fairness of any plan of reorganization could be made. Absent the requisite valuation data, the Court was in no position to exercise the 'informed, independent judgment—which appraisal of the fairness of a plan of reorganization entails'."

And proceeding to discuss the aspects of that valuation problem, the Court said:

> "In the first place, there must be a determination of what assets are subject to the payment of the respective claims. This obvious requirement was not met."

The Court went on to declare:

> "According to the District Court the mortgaged assets are insufficient to pay the mortgage debt. There is no finding, however, as to the extent of the deficiency or the amount of unmortgaged assets and their value."

The Court also declared:

> "The full and absolute priority rule of Northern Pacific Railway Co. v. Boyd, 228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931, and Case v. Los Angeles Lumber Products Co., supra, would preclude participation by the equity interests in any of those assets until the bondholders had been made whole."

Further considering the matter of valuation data and as the second aspect, the Court declared:

"In the second place, there is the question of the method of valuation. From this record it is apparent that little, if any, effort was made to value the whole enterprise by capitalization of prospective earnings. The necessity for such an inquiry is emphasized by the poor earnings record of this enterprise in the past."

Appellants make a separate point of the question of fairness, apart from the question of the lack of evidence and the insufficiency of the findings. But the whole matter is somewhat interrelated, and therefore appellants proceed now to point out what the Court said in the *Rock Products* case about methods of valuation. The Court referred to the opinion of Mr. Justice Holmes in *Galveston, Harrisburg & San Antonio Ry. Co. v. Texas,* 210 U. S. 217, 226, 28 S. Ct. 638, 639, 52 L. Ed. 1031, where he said:

> "The commercial value of property consists in the expectation of income from it."
>
> "The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be fair and equitable."

Most of what has just been quoted applies to the *Provident* case, although there may be some question as to whether or not appellants can be concerned with the matter of feasibility. The Court proceeds:

> "Since its application requires a prediction as to what will occur in the future, an estimate, as distinguished from mathematical certitude, is all that can be made."

"But that estimate", the Court declares, "must be based on an informed judgment which embraces all facts relevant to future earning capacity and hence to present worth, including, of course, the nature and condition of the properties, the past earnings record, and all circumstances which indicate whether or not that record is a reliable criterion of future performance".

Now the language of that case has peculiar application to the *Provident* case, because, while it is true that the appellee is a public corporation and therefore not subject to enforceable decrees, as might be in the case of a private corporation, and while it is true its assets cannot be taken under order of the Court and applies by fiat to the discharge of the indebtedness of the corporation, nevertheless, it is true that this district owns in substance all of the lands within its boundaries as well as the public works, canals, ditches, rights-of-way, other properties of the corporate entity, and that the chief beneficiary of that holding of that property is the bondholder. It was so declared in the case of *Provident Land Corporation v. Zumwalt,* 85 Pac. (2d) 116, 96 C. D. 497, 12 Cal. (2d) 365, where the Supreme Court of California declared with reference to this district in a case in which Mr. George Freeman, counsel for appellee here was counsel for the district:

> "The land is the ultimate and only source of payment of the bonds. It can never be permanently released from the obligation of the bonds until they are paid."

And declared further:

> "* * * the lands remain in trust, and the district exercises its powers, however broad, as a trustee. Once it is made clear that the lands are held in trust, it necessarily follows that their proceeds, whether by sale or lease, are likewise subject to the trust."

The Court then proceeded to discuss whether or not the payment of the bondholders is one of the purposes of the trust, and the Court declared:

> "On this question defendants and amici curiae, vigorously contend that the purposes of the act are to construct irrigation works and provide for irrigation of the lands of the district. They concede that the district is authorized to borrow money for these purposes, but assert that creation of debt is not one of its purposes. They concede that the act requires repayment of the money borrowed, but assert that this is not one of its purposes. This type of argument, however, tends to prove too much, for it is difficult to conceive of the legitimate use of any funds of the district, derived in any manner, for something which is not a purpose of the district. How can the assessments, when collected, be paid to bondholders, if payment of their obligations is not a purpose of the act? * * * But laying aside quibles as to the exact measure of the phrase 'uses and purposes', it seems clear that if the district is to be created and to function on borrowed money, repayment of the money is not a wholly immaterial and foreign objective * * * Among other purposes of the act, therefore, is the repayment of the bondholders of the district, and it follows that this is one of the purposes for which the trust money is held."

Therefore, it seems that the relationship between the bondholder and the district in this case is even more subject to construction in favor of the creditor, because not only does the relationship of creditor and debtor exist, but it is a confidential relationship. It is a relationship of trust created by public statutes to be performed by public officials. And since in this case substantially all of the lands are owned by the district in trust for uses and purposes of the Act, among which is the payment of the bondholders, it seems all the more clear that the language of the *Consolidated Rock Products* case should be applied in this case.

In the light of this situation, therefore, appellants point to the absence of any valuation data sufficient to warrant the court in reaching a conclusion as to the fairness of the plan. Not only is there an entire absence of anything in the record whatsoever to show the value of the land and assets of this corporation, but the bankrupt makes not even a pretense of showing what its income and expenditures have been over this period of time since it went into default. Not even the appraisal of the R. F. C. was before the Court, nor was there any other appraisal of the assets of the district. There was no balance sheet or statement of capital assets or statement of income; there was no accounting nor statement of receipts and disbursements; there was no history of the financial affairs of the district, but merely conclusions of two or three witnesses who were of the opinion that the plan was fair.

THIRD PROPOSITION: THE PLAN OF COMPOSITION IS UNFAIR.

Assignment of Error 3: The plan of composition herein is unfair, inequitable and unjust and is not for the best interests of the creditors and it discriminates unfairly against the appellants. (Tr. p. 215.)

Appellants have discussed under the second proposition the failure of the evidence to sustain the findings and of the findings to sustain the decree. Under the following argument, which somewhat overlaps appellants' second proposition, the evidence as to fairness will be further analyzed on the theory that it shows positively that the plan is actually unfair, unjust and discriminatory.

Of course, one of the points of fairness pertains to the bonds of Nelson Taylor. That matter has been covered in a separate heading and will not be further touched upon here. Another point of unfairness is the payment of the interest coupons to January 1, 1931. It may be that this point could be more properly discussed under the heading of lack of good faith, but it should at least be mentioned here. This part of the plan is unfair because it appears to the appellants that by pre-arrangement the benefit of this payment goes largely to certain individuals who are connected with the Provident Land Corporation and not to the bondholders. It appears from the entire record that the major part of the coupons due January 1, 1931, by some mysterious means found themselves in the hands of George McKaig. Now appellants do not contend that

George McKaig should not have been paid for his services to the Provident Land Corporation or that there was anything improper or unfair that he should have been the recipient of such benefits. But it does appear, at least to the appellants, and they contend that full disclosure was not made to all of the parties of this situation and that the bondholders did not realize the real significance of their not having coupon No. 25 attached to their bonds when they turned them in. That significance only appeared when the plan suddenly blossomed forth to provide full payment for that coupon and no payment for any other coupon.

But to take up the main question of fairness. The indebtedness of the district was $957,000 principal amount of bonds with interest from July 1, 1930. A loan of $193,500 was obtained from the R. F. C. This is $200 a bond principal with nothing for interest except the peculiar payment of one coupon due January 1, 1931.

Appellants have already shown what the evidence lacks by way of support of the proposition of fairness. We will now show what it proves.

It proves that some 10,000 acres of this land is to be arbitrarily taken out of the district. No adequate reason is shown by the evidence for taking this land out of the district or for relieving it from the bond indebtedness. Appellants can only set forth their suspicions and their explanation why in their opinion it was taken out of the district. That reason

was it benefits certain private interests whose position in the matter is not apparent. We do not intend to make much point of the fact that Charles F. Lambert, fiscal agent, purchased a limited acreage for his son and his daughter, but on the other hand neither is it shown who is going to benefit by receiving the 10,000 acres of land absolutely debt free from the debt of this district. It may well be that the land may not have a high cash value on the open market as conditions appear. But the record is full of evidence that the district has a very healthy expectation of obtaining a very satisfactory price for this land from the Biological Survey, or at least for a large portion of it. The Biological Survey paid a very substantial sum for the so-called Spaulding Ranch, out of which the district received $52,000.[16] In any event, the district witness declined to commit himself as to how much that land was worth so far as the Biological Survey is concerned. It is the contention of appellants that this entire transaction should have been laid before the court more frankly because of the great probability that a sum of money which may equal more than half of the total indebtedness of this district may be received from the Biological Survey for that one item alone.

$7 per acre for 10,000 acres is $70,000; at $15 an acre, $150,000. We believe that the price which

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16. And one of the peculiarities of that transaction was that the original owners of the land who had lost their title by nonpayment of indebtedness received very substantial payment. Another feature of the transaction is that Mr. Freeman, counsel for the district in this case, benefited very materially out of that transaction. The record does not show the facts stated in this note.

will eventually be paid by the Biological Survey will be at least that amount and that the net result in favor of the Provident District will be from $75,000 to $100,000, which added to the amount for which the lands to be left within the district have been sold will entirely liquidate the indebtedness of the district, resulting therefore in an absolute outright shift of the land to the tenants who are now within the district.

The second point of unfairness that is made is that in liquidating the indebtedness of the Reclamation District the district actually paid $350 per $1000 bond, whereas it only offers $200 per $1000 bond in this plan of composition. (Tr. p. 103.) And as a matter of fact some of the bondholders actually got $425 per bond. (Tr. p. 125.)

The next point that appellants make is based upon judicial knowledge by the court. As above already commented, the court will take judicial knowledge of the fact that it is costing $75 to $165 an acre throughout the west to put raw land under irrigation. And that the federal government is now actually engaged in many undertakings in the west to bring new lands under irrigation. Now it probably is a fact that most of this land to be placed under irrigation is not worth over $5 an acre as raw land in its present condition. Nevertheless, the federal government, through the Reclamation Bureau, proposes to expend millions of dollars at a cost that might roughly be estimated at $100 an acre, to bring land under irrigation.

The Bureau of Reclamation in its report January 28, 1941, Senate Document 18, 77th Congress, entitled "Program for Water Conservation and Utilization" stated at page six that the over-all per acre cost of nine projects authorized, with a total cost of $14,622,000, is $165. If the federal government is justified in spending $165 an acre to bring these projects into being how can it possibly be fair to pay off bondholders on the basis of $14.50 per acre for only half of the land of the district?

Now, if it is worth while to do that, either from the point of view of the government or from the point of view of private interests, or from any point of view, how can it be said that it is fair to trim the debt on the Provident land down to a mere $14.50 per acre. If the federal government through the R. F. C. is right in saying that the only indebtedness which the lands of this district can bear is $14.50 an acre (if they really do say that) then how can the government through the Reclamation Bureau be right in saying it is justified in expending $75 to $165 an acre to bring new land under irrigation?

Surely the only answer is to deny the fairness of the plan in this case.

There are but three resident land owners left in this district. (Tr. p. 132.) And therefore in effect the district owns all of the land. It operates this land as shown before and hereafter proven in trust for the benefit of the principal and only actual beneficiary, the bondholder.

Mr. Vogel, one of the Commissioners of the Bond Commission, testified that in his opinion the new bonds do not exceed 60% of the value of the corporate assets of the district. (Tr. p. 138.) He believes that the plan is fair, but the only reason that he could give was that the district could not give 100% of the value to the bondholders because he contends you cannot borrow 100% on a piece of property at the bank.

Also the plan is unfair because it allows over $20,000 in fees for the fiscal agent. This is more than 10% of the total amount paid to bondholders on a million dollar indebtedness. This expense is exorbitant and is of course at the cost of the bondholders themselves. That fee is as big as was allowed in some of the cases like Imperial and Merced.

The district offered no evidence to the effect that the sale of its land would aid the district or the bondholders nor that the buyers had not bought subject to the debt. Obviously none would buy if it were not more profitable than renting.

Another reason that the plan is unfair is because one-third of the crop goes to the landowner out of which the landowner pays the water and the assessment tax. Therefore the land operator can operate the land, as shown by the record, and pay for his costs of production and still make what is a satisfactory profit to him. This is the evidence in the case. There therefore is a substantial equity in this land over and above the cost of operation. That

equity is represented by one-third of the crop which the landlord gets. Whether the landlord be the district, acting as trustee for the benefit of the landowners, or whether it be private owners, it is the same. The fact is that this district has been able to operate these lands and build up some sort of a surplus even under a policy of favoring, as the Supreme Court said, the lessees in the district. (*Provident Land Corporation v. Zumwalt,* supra.) With any effort at all the land could be operated by the district officials on a lease basis and out of the proceeds the expenses of operation paid, and a return made to the bondholders.

If these municipal bankruptcy cases are to be looked at from the point of view, as seems to be the trend, of social and political philosophy, then we think the situation fairly should be examined on that basis. And in this instance there cannot be any social or political justification for transferring the lands of this district in effect from the bondholders to the lessees now in the district. This district has had no difficulty in finding tenants for its lands. Why should it not continue to operate it in that manner, only actually, and in good faith for the benefit of the bondholder? If it were a case of taking the lands away from people who owned their farms, social and political evils might result. But that is not the case here. This district already owns and holds the land and has operated it for a long period of time. And furthermore, while appellants do not hold with the new jurisprudence based on "social

justice" they may as well present the point that the present administration of the United States, particularly the Department of Agriculture is giving consideration to and in some degree advocating a limited system of public ownership of land in those instances where the state takes tax title. This land could be held by the district and operated in that manner as a unit.

Henry A. Wallace, in his report as Secretary of Agriculture for 1940, U. S. Printing Office 1940, at page 68 states:

"There is no more good land that is either free or cheap."

In the report of the select committee to investigate interstate migration of destitute citizens, being House Report No. 369, 77th Congress, First Session, the Committee called attention to the Land Policy Act of Arkansas in 1939 (p. 20) under which suitable lands now held by the state as a result of tax forfeiture are made available to homeless families under conditions conducive to permanent settlement. The Committee felt that agricultural states could make no better use of state owned land than to follow this example.

The National Resources Planning Board, composed of Frederic E. Delano, Charles E. Merriam, George F. Iantis, in its report on rural lands made by the land committee of the National Resources Planning Board, Government Printing Office 1940, in discussing irrigated areas at page 19, speaking

of the poorer areas that are placed under irrigation, said:

> "Farmers who have made heavy investments on poor land are loath to abandon them; and even if they did other farmers would tend to reoccupy them. Furthermore, the organizations supplying water often cannot legally refuse water to inferior land. The public acquisition of both the inferior land and the water rights connected therewith, is therefore necessary to the reconstruction and establishment of a sound farm economy in some irrigation districts."

The report goes on to say:

> "It is evident that public acquisition of land under conditions indicated earlier in this report is a useful instrument of land use adjustment for state, county and municipal governments as well as for the federal government." Page 22.

At page 96 in a special report by an interim committee of the U. S. Department of Agriculture on "State Legislation for Better Land Use", issued by the U. S. Government Printing Office, April 1941, at pages 54 and 55 this striking statement is made:

> "When a state owns agricultural land it has an opportunity to set an example for the adoption of forward looking leasing practices."

The report goes on to point out that through tax delinquency lands come into the hands of the state. The report says:

> "These lands could be used for settlement by farm tenants if the proper terms were offered for the acquisition of the land."

The report referred to the tenant purchase program under the Bankhead-Jones Act.

Without going further into discussion of this feature, appellants point out that leasing programs are coming more and more to the attention of public officials, and more genuine experimentation along that line is needed. Here is an instance where it can be done, certainly without harm to anyone and probably with great benefit to the bondholders.

In the case of *Anderson-Cottonwood v. Klukkert*, 13 Cal. (2d) 191, it was held that where an irrigation district owns the land and takes title by tax process, such land is no longer subject to taxation by other state agencies, because the property is state owned property and therefore free from taxation. Therefore, there would be no interference by the Reclamation District or the County or the State in the handling of this land in the manner as it has been in the past. The total return, therefore, from the land could be applied, after payment of the operating expenses of the district, to liquidation of the indebtedness. And if the lessees who are now on that land feel that they would be justified in buying the land, assuming an indebtedness of $14.50 per acre to the bondholders, and still retain a profit to themselves, which would also necessitate their paying the reclamation, county and state taxes which will be assessed against these lands, then it would seem that as a practical matter more could be obtained out of the proceeds of this land in the manner that appellants now suggest, namely, that it be re-

tained with the title in the district, leased to the land operators, who would then pay to the district the total amount of all these other payments including the landlord's profit.

Before the landlord can receive anything as a result of his contribution of the land it is necessary that the operator and his family be provided a living and that the out-of-pocket cost of production be paid. Regardless of the size of the farming unit, the cash cost of production must be paid before the landlord can expect the rent. The extraction of more rent than the farm unit can pay can only be temporary. What we are looking for in this case is what rent is left after the costs of production are paid. We have no real study of the situation. The rent, over and above the cost of production, belongs to the bondholders, less, of course, the cost of operation of the district.

Lastly, we call attention to the striking remarks of the Court at Transcript page 197, where the Court inquired what percentage of the bondholders had accepted. Mr. Freeman replied 94% plus. Undersigned counsel pointed out that "the Supreme Court says that that does not count". The Court answered, and the answer indicated that the Court based its conclusion in this case *very largely upon the fact that 94% of the bonds had accepted the plan*. For this reason alone the cause should be reversed. (*Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 11.)

FOURTH PROPOSITION: THE COURT ERRED IN FAILING TO FOLLOW THE LOCAL LAW APPLICABLE TO THIS DISTRICT AND WHICH WAS THE LAW OF THE CASE.

Assignment of Error 15: The Court erred in taking jurisdiction of a public trust imposed upon the Provident Irrigation District and administering the same and in depriving the appellants of their rights as beneficiaries of such trust. (Tr. p. 216.)

31. The plan of composition violates local law and it is discriminatory and unfair in that it violates rules of law and law of the case laid down in the case of *Provident Land Corporation v. Zumwalt,* 94 Pac. (2d) 83, and related cases.

Certain matters pertaining to this district are in effect *res judicata.*

Passing upon a plan of composition, the bankruptcy Court is bound by local law. (*Ginsberg v. Lindel,* 107 Fed. (2d) 721, 725, 726; *American United Mutual Life Ins. Co. v. City of Avon Park,* 108 Fed. (2d) 1010, 61 S. Ct. 157.)

The law of *res judicata* is that legal principle by which a former judgment operates between the parties and privies as a conclusive adjudication of all questions, both of law and fact determined by the Court. This is true of "estoppel by judgment" where the former adjudication is not void no matter how erroneous or irregular it may have been. The general rule is, however, that where the former adjudication invokes as a bar or estoppel the decision on a point of law, the law of *res judicata* trenches upon that of pre-

cedent or *stare decisis,* 34 C. J. 746. However, in the instant case we have a different or added principle, namely, that the federal Court, in construing the rights under state law and in construing state law, must follow the decisions of the highest Court in the state, *Erie Railroad v. Tompkins,* 58 S. Ct. 817, 304 U. S. 64.

We have as applying to the facts of this case a decision of the highest Court which is not only *res judicata* of the law of the case but also enunciates the principles of law which apply directly to this district and this case and which the bankruptcy Court, appellants submit, should of necessity follow.

Appellants refer to the case of *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365 and related cases, particularly *Moody v. Provident Irrigation District,* 12 Cal. (2d) 389.

In *Provident Land Corporation v. Zumwalt,* supra, there was involved an appeal from the Superior Court to the Supreme Court of the State of California in which George R. Freeman, counsel for the district here, appeared for the district. The action was brought by the Provident Land Corporation (holding approximately 80% of the bonds of the Provident Irrigation District) against one Zumwalt and the district. On January 7, 1936, the directors of the district passed a resolution declaring the sum of $10,000 in the general fund constituted a surplus and ordered that it be set aside for purchase of bonds of the district. The district purchased bonds of Zumwalt and others totalling 50 bonds, for the sum of $10,000.[18] A companion

18. It had money to buy unmatured bonds from its "friends" in 1936 but no money to pay Nelson Taylor's 3 bonds due in 1930.

case was that of *Provident Land Corporation v. Provident Irrigation District,* 12 Cal. (2d) 791 and *Provident Land Corporation v. Benoit,* 12 Cal. (2d) 790. These cases had for their objective the setting aside of the sales, on the theory that the moneys which were applicable to bond payments should be paid out, not in purchase of bonds indiscriminately, but on the bond indebtedness of the district *in the order of original presentation to the treasurer.* The Court discussed at considerable length the economic conditions presented in that case. After reviewing the method of payment of bondholders by which under Section 39 of "the California Irrigation District Act" the directors levy assessments and under Section 43 the district sells the property if the taxes are not paid and at the end of three years takes a deed under Section 47, the Court said that economic conditions have prevented the working out of this plan (for payment from the assessments levied). The farmers in the agricultural area embraced by various of these districts have found it increasingly difficult to meet their obligations. When delinquencies begin to mount it becomes impossible to stop them because of the fact that the remaining lands face continually rising assessments. Moreover, there were no purchasers for the land, because the new land owner would be immediately liable for the assessments which would be pyramided. And as a result some districts own practically all their land. Land thus owned is not subject to assessment, and therefore produces no revenue in this manner. Districts having title to this enormous acreage which it is unable to sell have turned to leas-

ing the land. In the case of the Provident District this was done for several years. All this appears from the opinion of the Supreme Court. The money was placed in the general fund and created a surplus. In this case Mr. Freeman contended, as shown by the opinion of the Supreme Court, that the sole remedy of the bondholders was to compel a levy of assessments, citing the case of *Mulcahy v. Baldwin,* 316 Cal. 517, and that funds acquired by the district might properly be used for *any* of the purposes for which the district was formed; that the use of rentals to retire bonds at a discount is a proper use. (The Court pointed out that the benefit to landowners resulting from the retirement of any part of the outstanding indebtedness is largely illusory because of the virtual disappearance of the landowner.) The Court declared:

> *"The true situation seems to be that the directors of the district by their present policy are administering the land for the benefit of lessees who are able to rent the land at exceptionally low prices and for those particular bond holders whose bonds are purchased and retired. The delinquencies have gone too far in this and other districts to save the landowners."* (Emphasis ours.)

Thus the Supreme Court disposed of the point—namely, declared that there are no landowners to save and as shown the Supreme Court severely criticized Mr. Freeman's Board of Directors for administering the land for the benefit of the land operators in the district.

Mr. Freeman took the position "that the district had fulfilled its entire duty to the bondholders by levying assessments and selling the land for delinquency". Thus he would have at that stage of the proceeding dismissed the bondholders without any rights whatever in favor of the land operators of the district.

As we have shown above in this brief the Court went on to declare that the *statute was intended to secure the bonds by the proceeds of the land, whether by sale, rental or otherwise.* The Court declared also: "We do not understand how a debtor owing $360,000 long overdue can have a surplus of $10,000" or how the district could take all the money derived from the land and use it for purposes *other than the primary object of paying the overdue bonds,* and declared that when the directors have a surplus over and above operating needs two things should be clear, first, that the money should go to the bondholders and second, that it *"should be paid on past due bonds and coupons in the order of their presentation".* Here we have the law of the case, a declaration by the Supreme Court that moneys coming from the sale of lands in this district must be applied, after the payment of operating expense of the district, to payment of bonds and coupons *in the order of presentation.* In the instant case the evidence shows that the district has made sales of 46 parcels of land, 11294.49 acres, for the total sum of $112,944 (Tr. p. 104) and it proposes to apply this money contrary to the decision in the case of *Provident Land Corporation v. Zumwalt* by turning

it over to the R. F. C. and reducing the general indebtedness of that district without regard to the order in which the bonds and coupons may have been presented under Section 52 of "the California Irrigation District Act". In the cited case the Supreme Court condemned as illegal the use of proceeds of land rentals and sales for the reduction or payment or purchase of district bonds, which is the exact proposal of the R. F. C. (Tr. p. 97.) This Court must reverse the Supreme Court of California in the *Zumwalt* case to approve such procedure.

The second point which we raise under this heading is that the Court in the *Zumwalt* case held that the lands are impressed with a trust. "The lands remain in trust and the district exercises its powers, however broad, as a trustee." If this is true therefore, how can this trustee come into bankruptcy and thus rid itself of its trust obligation? Even if it can thus dissolve its obligations as a debtor it can never dissolve them in that manner as a trustee. The Court proceeds in its declaration under its ninth point to declare that the payment of bondholders is one of the objects of the trust. In paragraphs nine and ten the Court declares that the land is the ultimate and only source of payment of the bonds and "it can never be permanently released from the obligation of the bonds until they are paid".

This is a declaration that in the Provident Irrigation District the land can never be released from the obligation to pay the balance due. It may be that under this composition plan the district can borrow

from the R. F. C. a sum of money sufficient to pay $200 of the face amount of each bond. But the land can never be discharged from the obligation to pay the balance as declared in the case of *Provident Land Corporation v. Zumwalt.*

As was said in that case "this use of funds contrary to the whole intent of the act is in our opinion a violation of the trust impressed on the land under Section 29". The Court does not say, of course, that the payment of bonds is the sole purpose of the trust. It is but one of the purposes. The land may also be a source of funds to enable the district to function. The Court pointed out also that another method of raising operating funds exists, namely, the charging of tolls for the use of water under Sections 39 and 55 of the Act. The Court declared that the district could in its discretion "determine that some of the proceeds of leasing the lands are essential to operation and maintenance". "But" the Court declared, "any surplus over and above operating expenses remains subject to the trust and should go to the payment of bondholders".

The case of *Moody v. Provident Irrigation District* decided by the Supreme Court of California the same day is a case in which the undersigned counsel appeared for Moody, who is one of the appellants in the instant case. Mr. Freeman was counsel for the respondent, the irrigation district.[19] In that case, Moody brought an action on his three matured bonds and the interest coupons. The record showed that there had

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19. Mr. Laine was also in these cases.

been a general default in the payment of principal and interest on bonds of the district January 1, 1931. The prayer of the complaint was for judgment in the amount of the principal of the bonds and coupons and 7%. The Court after deciding that it is a settled law that an irrigation district is a governmental agency, stated that there is no constitutional prohibition against a subsequent agreement being entered into by the bondholders of the district under the terms of the statute (Section 52) specifying that bonds and coupons be paid, not when they are due, but as soon as money is available therefor. The Court declared that the fact that the annual assessments may never realize enough money to pay the indebtedness of the district is "entirely beside the question". The Court declared that "the property of the district, so far as it owns any property, constitutes a public trust" and is not subject to levy and sale by a creditor. The statute of limitations, the Court declared, does not run under these circumstances until the district has money in its hands to pay the obligations. And the Court declared that the registering of the bonds and coupons "constituted a new agreement" and tolled the statute of limitations until there was sufficient money in the hands of the treasurer and notice had been given. The Court cited authority that the effect was a deed of trust, setting apart property under which money due was to be paid at a given time. The Court declared that the entry of a money judgment would give the bondholders no additional rights or remedies. He practically had a judgment.

Stated differently this decision holds that when bonds and coupons which are due by their face are presented to the treasurer for payment under Section 52 of "the California Irrigation District Act", a new contract is made between the bondholder and the district by which, in effect, the bonds and coupons *are not due* until funds have been received by the treasurer for the payment of such bonds and coupons. This case and the case of *El Camino Irrigation District v. El Camino Land Corporation,* 12 Cal. (2d) 378, also decided the same day by the same Court, declare that the only remedy is for the bondholders to wait until the district has produced revenue by its ordinary process to pay the bonds.

Under these circumstances appellants declare and urge: The law of California and the law of the case is, and that it is *res judicata* that:

(1) No bonds or coupons of the Provident Irrigation District are due until funds are on hand available for the payment thereof, and therefore the district is not unable to pay its debts as they mature.

(2) That a public trust has been created and not only does the relationship of debtor and creditor exist but in this case the officials of the district are trustees holding the lands and assets of the district in main for the purpose of paying the debts due appellants.

(3) The plan of composition is void because it conflicts with the declarations of law and the

determinations of fact obtained in these cases whereby the proceeds of land rental must be applied as well as the proceeds of sales must be applied to the payment of the indebtedness in the order of presentation and cannot be turned over to the R. F. C. any more than it could have been paid over to Zumwalt, the Capital National Bank, or Benoit.

(4) The land in the district can never be permanently relieved of the bond debt.

FIFTH PROPOSITION: THE PLAN OF COMPOSITION IS NOT PRESENTED IN GOOD FAITH.

Assignment of Error 5: The offer of the plan and its acceptance are not in good faith. (Tr. p. 215.)

30. The plan of composition is unfair and discriminatory in that it provided for payment of the July 1, 1931 coupons (January 1) because they were largely held by a group of creditors who had by arrangement managed to get control and ownership thereof, and that the payment in full of that coupon was discriminatory in that the amount paid therefor should have been prorated amongst all of said coupons. (Tr. p. 219.)

Frankly, the appellants are in some doubt as to the propriety of presenting arguments on this point. They are firmly convinced that this is a case in which the decision should be set aside because of the want of good faith. They concede that the evidence may be

somewhat lacking in this regard. Certain things have transpired which make it seem to appellants that they ought to present this point. First of all at the hearing before the trial Court counsel for appellants warned and cautioned the Court that the Court might be imposed upon and that there was in the belief of counsel the possibility of certain transactions showing bad faith in the presentation of the plan. The Court expressed to counsel in open Court its belief the Court could look into and determine that question for its own protection and for the benefit of all the parties, and there is in the record a finding that the Court has examined all the documents and finds the plan free of the possibility of bad faith.

Appellants will present this point quite briefly and charge a want of good faith based on the following:

(1) A deliberate and unfair effort was made in this case to deprive Nelson Taylor of the payment of his three bonds. Even counsel for the district admits at least that the failure to pay the bonds was due to an "error" on the part of the district officials because they believed the bonds were outlawed, whereas subsequently the Supreme Court of the State of California declared that such bonds were not outlawed. They deliberately paid other bonds and coupons in lieu of paying those bonds as shown by the record in this case, and now they do not seek to correct their error. All other bonds of 1930 maturity have been paid except these two. These two should have been paid. Failure of this district to include a

provision therefor in the plan is evidence of want of good faith.

(2) The plan is not in good faith because the district failed to disclose the true value and circumstances regarding the sale of the lands taken out of the district. This land, it appears, will be sold to the Biological Survey. Yet all of the facts and questions relating to this sale were withheld. Furthermore, the taking of 10,000 acres out of the district itself was not shown to be justifiable. The motive and purpose is very unclear.

(3) Want of good faith is shown by the payment of the coupons. The R.F.C. did not have any of these coupons. They were placed in select hands. As appellants have indicated before, they have no objection to McKaig or any other person who performed services being paid. They should be paid. But appellants object that the plan should have been set up in such a manner as to specially take care of one creditor. It appears that the general creditors of this district did not have coupon No. 25. When they showed up they largely showed up in the hands of Mr. McKaig. Perhaps appellants should not go outside of the record. But in a bankruptcy case the case is not over until the decision is final and the appeal practically amounts to trial *de novo*.

Therefore, there is attached Appendix A.[20] Appendix A is an extract from a complaint filed in the Superior Court of the State of California in and for the City and County of San Francisco, Action No. 297,930,

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20. See especially (pages xvii-xxiii).

Louis Bartlett against Provident Land Corporation, George H. McKaig, the Bondholders Protective Committee of the Provident Irrigation District and others, in which Mr. Bartlett makes some very startling charges. Mr. Bartlett was the attorney representing the Provident Land Corporation in their litigation against the Provident Irrigation District, supra. There must be some basis for this charge. The undersigned counsel had warned this Court at the commencement of the hearing in the *Provident* case that there might be facts and circumstances showing a want of good faith, and the like. The Court indicated that it was well able to investigate those matters and not to be deceived. Appellants believe that the Court was deceived, that one of the points of exception was with relation to this $30 coupon which was to be largely paid to Mr. McKaig. We do not join in any suggestion or request that Mr. McKaig should not have Coupon No. 25, but we do not think that the plan should have been arranged after he got those coupons, nor provide that this coupon should be paid in discrimination against other coupons.

SIXTH PROPOSITION: THE PLAN OF COMPOSITION IS NOT SUPPORTED BY LOCAL LAW.

Assignment of Error 6: The Provident Irrigation District is not authorized by local law to take all action necessary to be taken to carry out the plan of composition. (Tr. p. 215.)

The plan of composition must be supported by and authorized by local law. Section 83e (6), Bankruptcy

Act of 1898; 11 U. S. C. 403, 83e (6); *American United Mutual Life Ins. Co. v. City of Avon Park,* 108 Fed. (2d) 1010, 61 S. Ct. 157; *U. S. v. Bekins,* 304 U. S. 27, 82 L. Ed. 1137, 58 S. Ct. 811.

The resolution adopting the refunding plan is set forth at transcript p. 11, and it provides at transcript p. 15 that the outstanding debt of the district, consisting of $957,000 principal amount of bonds and "all unpaid interest" *be retired* by the payment of 20 cents for each dollar of principal and that also all interest coupons maturing on or after July 1, 1931, be delivered with the bonds. It also recites at transcript p. 16 that refunding bonds in the amount of $193,500 be issued and a contract be entered into with the R.F.C. to acquire these refunding bonds.

The resolution of the R.F.C. (Tr. p. 70) recites the principal indebtedness as $957,000 (Tr. p. 71) and the interest unpaid on August 15, 1939, $443,672.50. This of course includes all the interest that matured prior to July 1, 1931, as well as that which matured afterwards. And the resolution goes on to provide a loan of $193,500 granted for the purpose of discharging all of this indebtedness at the rate of $200 per each $1000 bond, with nothing for interest.

Order No. 10 of the Districts Securities Commission authorized the issuance of the bonds (Tr. p. 149) and also recites the principal indebtedness of $957,000. It recites on the same page "that the amount of the loan necessary to refund the outstanding bonds of the Provident Irrigation District does not exceed $193,500". *But there is no approval of*

the additional feature of the plan for the payment of the coupons which matured January 1, 1931, and in this respect, therefore, the plan is not supported by the statutes of the State of California, there being no approval by the Districts Securities Commission and it even appearing that the entire matter is defective and not in good faith because of the fact that this additional feature of the plan is not authorized by the Districts Securities Commission.

Furthermore, the matter was submitted to the electors of the district as required by statute and on March 15, 1940 (Tr. p. 163) the voters of the district voted upon a proposition as to whether the district should enter into a contract with the R.F.C. providing for the issuance of refunding bonds "for the purpose of reducing and refinancing the outstanding indebtedness of said district under and pursuant to and in accordance with the resolution adopted by the Reconstruction Finance Corporation dated December 20, 1939". This election was required by Sections 3 and 11 of Statutes of California, 1917, p. 243, as amended, Section 3 of which provides that any proposal to enter into a contract with the U.S. to issue bonds shall be voted upon at an election. The ballots are required to contain a brief statement of the general purpose of the contract and the amount of the obligation to be assumed.

It is therefore submitted that the plan of composition providing for payment of interest coupons prior to July 1, 1931, is not supported by the law of California and is contrary thereto.

CONCLUSION.

Appellants respectfully urge that the decree be reversed, the plan being unfair, unjust and discriminatory. It is peculiarly and wilfully unfair and unjust to Nelson Taylor, and certainly it is unfair and unjust to all the other appellants. Discrimination is shown. The district has long flouted local law, even in the preparation of its plan. The decree violates all of the points decided by the California Supreme Court re this district. All the appellants respectfully submit that the decree should be reversed; Nelson Taylor submits specially that in any event his claim should be paid in full.

Dated, Turlock, California,
July 11, 1941.

Respectfully submitted,
W. Coburn Cook,
Attorney for Appellants.

(Appendix A Follows.)

Appendix A.

Appendix A

EXTRACTS FROM CROSS-COMPLAINT FILED MARCH 5, 1941, IN THE SUPERIOR COURT OF CALIFORNIA AT SAN FRANCISCO

In the Superior Court of the State of California, in and for the City and County of San Francisco

No. 297,830

Provident Land Corporation (a corporation), Plaintiff,

vs.

Louis Bartlett, et al., Defendants.

Louis Bartlett, Cross-Complainant,

vs.

Provident Land Corporation (a corporation), George H. McKaig, W. G. Aldenhagen and E. O. Kaufmann, individually and as members of the Board of Directors of said Provident Land Corporation, George H. McKaig and E. O. Kaufmann, individually and as members of the Bondholders Protective Committee of Provident Irrigation District, First Roe, Second Roe, Third Roe, Fourth Roe, Fifth Roe, Sixth Roe, Seventh Roe, Eighth Roe, D. and R. Company, S. and G. Company, X. Company, Y. Company, Z. Company, Blue and Gold Company, Cross-Defendants.

CROSS-COMPLAINT

Paragraphs from First Cause of Action:

VI.

That on or about May 6, 1936, the sole assets of plaintiff and cross-defendant Provident Land Corporation were bonds of said Provident Irrigation District; that said bonds had been acquired in the following manner: After the organization of cross-defendant Bondholders' Protective Committee of Provident Irrigation District and before the incorporation of plaintiff and cross-defendant Provident Land Corporation said cross-defendant Bondholders' Protective Committee of Provident Irrigation District had acquired said bonds from the original owners and holders thereof in connection with efforts to protect and assert the rights of said bondholders and to obtain a liquidation thereof and realization thereon; that after the incorporation of plaintiff and cross-defendant Provident Land Corporation said corporation acquired such bonds from said Bondholders' Protective Committee of Provident Irrigation District and executed certificates for shares of the capital stock of said corporation to said original bondholders of said Provident Irrigation District in the ratio of one share of such stock for each bond of said Provident Irrigation District of the face value of $1000.00; that said certificates for said shares were never delivered to the respective share holders, and that on May 20, 1937, the Board of Directors of plaintiff and cross-defendant Provident Land Corporation, at a meeting thereof duly called and held, adopted a resolution reciting that the

shares of stock of said corporation representing such bonds should have been issued to cross-defendant Bondholders' Protective Committee of Provident Irrigation District as the owners and holders of said bonds, and, accordingly resolved to cancel said certificates for the shares of said corporation as theretofore executed and undelivered excepting to Pacific National Bank of San Francisco as trustee, and, in lieu thereof to issue to said cross-defendant Bondholders' Protective Committee of Provident Irrigation District a certificate or certificates for shares of stock of said corporation equal in number to the number of bonds so deposited with said Pacific National Bank of San Francisco, all in accordance with a permit from the Commissioner of Corporations of the State of California, dated October 1, 1935, and accordingly issued such certificate or certificates; that ever since said May 20, 1937, said cross-defendant Bondholders' Protective Committee of Provident Irrigation District have been the principal share holders of plaintiff and cross-defendant Provident Land Corporation.

IX.

That as a result of said services rendered by defendant and cross-complainant for and on behalf of said corporation plaintiff and cross-defendant and said committee cross-defendants as their attorney and counsellor at law since the 7th day of May, 1936, as hereinafter alleged, said Provident Irrigation District recovered title and possession of approximately 6730 acres of land within said district, title to which had been lost by misconduct and malfeasance of the

Board of Directors of said district; that said 6730 acres of land constitutes more than one-half of the entire area which is now within the bounds of said Provident Irrigation District in accordance with a plan for reducing and refinancing its outstanding bonded indebtedness, as hereinafter alleges; that through said proceedings undertaken by defendant and cross-complainant said Provident Irrigation District was enabled to resell all or practically all of the land remaining within the bounds of said district to bona fide purchasers at prices representing the fair value of said land; that through proceedings taken by defendant and cross-complainant said Provident Irrigation District also recovered for said Provident Irrigation District the sum of $10,000.00 which had been wrongly used by the Board of Directors of said district in the purchase of bonds of said district from L. M. Benoit, I. G. Zumwalt, and Capital National Bank of Sacramento, which bonds were unmatured and were preceded in priority by bonds owned by said corporation plaintiff and cross-defendant and by said committee cross-defendants and others who had registered their matured bonds for payment prior to the date of said wrongful purchase of said bonds of said Benoit, Zumwalt and Capital National Bank; that by the recovery for said district of said 6730 acres of land and said sum of $10,000.00, said Provident Irrigation District was enabled to have sufficient funds to compromise and payy all liens against said district and the lands therein and to pay all expenses of said plan of refinancing and reducing its outstanding bonded indebtedness as agreed upon by between said

district and Reconstruction Finance Corporation, as hereinafter set forth; that said sale of said land by said district to bona fide purchasers also provided a base for the levy of assessments for the purpose of paying interest and principal of a loan of approximately $193,500.00, which has been made by said Reconstruction Finance Corporation to said district as part of a plan for reducing and refinancing its outstanding bonded indebtedness of said district, as payments of such interest and installments of the principal of said loan will mature from and after January 1, 1941; that said results achieved by defendant and cross-complainant inured to the benefit of each holder of a bond of said Provident Irrigation District including said corporation plaintiff and cross-defendant and said committee cross-defendants; that had it not been for the services rendered by defendant and cross-complainant in bringing about the return to said Provident Irrigation District of the title and possession of said 6730 acres of land within said district and in bringing about the restoration to said district of said $10,000.00, said district would not have been in a position to effect the reduction and refinancing of its said bonded indebtedness or obtaining any loan from said Reconstruction Finance Corporation; that by and through and as a result of said services rendered by defendant and cross-complainant for and on behalf of said corporation plaintiff and cross-defendant and said committee cross-defendants as their attorney in said matters, said corporation plaintiff and cross-defendant and said committee cross-defendants were enabled to make an adjustment and compromise of all

of their contentions, disputes and litigation against said Provident Irrigation District and the directors and officers thereof and thereby to effect a sale of bonds owned by said corporation plaintiff and cross-defendant for $102,200.00, and to collect all coupons owned by it and appurtenant to said bonds and which matured prior to July 1, 1931, and unpaid amounting to $12,600.00, and said committee cross-defendants were enabled to sell bonds held by them for $17,400.00, making a total realization by said corporation plaintiff and cross-defendant and said committee cross-defendants of $132,200.00 or thereabouts.

Second Cause of Action:

II.

That on September 27, 1939, a meeting of the Board of Directors of plaintiff and cross-defendant Provident Land Corporation was duly and regularly called and held at its office at San Francisco and all of the directors, to wit, W. G. Aldenhagen, E. O. Kaufmann, and George H. McKaig were present, and said George H. McKaig, president of said corporation, presided. That said George H. McKaig stated thereat that said meeting was called for the purpose of discussing the possible sale of bonds of Provident Irrigation District owned by said corporation. That at said meeting the advisability of selling said bonds of said district owned by said corporation, the price which might be obtained therefor, and the method of effecting such sale were fully discussed by said directors. That the advice of said George H. McKaig was requested by

the directors other than himself at said meeting, and in response thereto said George H. McKaig presented to said Board of Directors in writing what purported to be and what was represented by him to be a summary of the situation and position of said corporation, plaintiff and cross-defendant herein, with respect to bonds of said Provident Irrigation District owned and held said corporation. That in said letter said George H. McKaig represented to said Board of Directors that it was then necessary to revise the plan of said corporation for the liquidation of bonds of said Provident Irrigation District for the par value of $576,000.00 owned or controlled by said corporation, and that there were then bonds of said district owned and held by persons other than said corporation plaintiff and cross-defendant, and not controlled by it, of the par value of $381,000.00; that after several conferences between said George H. McKaig and the Board of Directors of said Provident Irrigation District said district offered the following proposals for consideration:

1. That the Provident Irrigation District apply to the R. F. D. for a loan of $100,000.00, to be secured by new bonds of Provident Irrigation District covering 10,000 acres more or less;

2. That the Biological Survey purchase the 10,034, acres lying south of the Butte City road and west of Willow Creek at $14.50 an acre, making a total of $145,493.00;

3. Sell 10,000 acres of Provident Irrigation District lands lying to the north of Butte City

road and east of Quint Canal at $12.50 an acre, for a total price of $125,000.00; making a grand total of $370,493.00 to be distributed as follows:

(a) To the Provident Irrigation District bondholders, $143,750.00 (which is at the rate of 15% on Provident Irrigation District bonds).

(b) To the purchase of Reclamation #2047 bonds and warrants at 40% of par value, which amounts to $190,400, making a total of $334,-150.00 and leaving $36,343.00 for the settlement of the county taxes.

That at said meeting of said Board of Directors said George H. McKaig, by said letter, further represented that in order to complete the transactions described in the foregoing proposal from said Board of Directors of said Provident Irrigation District all of the time of said George H. McKaig exclusively for a period of about six months and considerable money would be required; that said George H. McKaig would be willing to undertake and perform said work for said corporation plaintiff and cross-defendant, but that, as all of the directors knew, said corporation was without funds with which to compensate said George H. McKaig or to defray the expenses of completing said transactions. Thereupon said George H. McKaig proposed to undertake to complete said transactions, to assist in securing a loan from said Reconstruction Finance Corporation and otherwise effecting said proposal from the Board of Directors of said Provident Irrigation District, and thereby to obtain for said

plaintiff and cross-defendant Provident Land Corporation 15 per cent of the par value of said $576,-000.00 of bonds of said district owned or controlled by said corporation. Said George H. McKaig further represented by said letter that a long period of time would be required in order to effect said transactions and said plan; that he, the said George H. McKaig, would be required to incur expenses which he estimated would total the sum of $25,000.00, to employ at least two men and an attorney, to provide money for traveling expenses and money to purchase the outstanding undeposited bonds; that all sums received in excess thereof would be retained by the said George H. McKaig as full compensation for his services and to reimburse him for all expenses connected therewith; that said offer was subject to acceptance by said Board of Directors and ratification by the stockholders of said corporation plaintiff and cross-defendant. That said George H. McKaig also represented to said Board of Directors that it was his desire and purpose to assist said corporation plaintiff and cross-defendant in every way possible to effect a sale of bonds of said Provident Irrigation District owned by said corporation in the best interests of its stockholders and that he, the said George H. McKaig, had given to said Board of Directors full information concerning the proposed sale of said bonds.

That thereupon said George H. McKaig stated to the other members of said Board of Directors of said corporation that he deemed it advisable that he should not be present nor participate in further discussion

with reference to the method of sale of said bonds which might or would be adopted by said board, in view of the fact that in his written memorandum he had offered two methods for consideration of said Board of Directors, one of which, if adopted, would require contractual relations between said corporation and said George H. McKaig as an individual; that thereupon said George H. McKaig left the room wherein said meeting was being held and remained out of said room for a period of twenty minutes; that thereupon the remaining members of said Board of Directors, to wit, said W. G. Aldenhagen and E. O. Kaufmann continued their deliberation and discussions and concluded, according to the minutes of said meeting, that the best interests of the stockholders of said corporation would be served by the sale of all of the bonds of said Provident Irrigation District held and owned by said corporation at the price of 15 per cent of the par value thereof; and that in view of the fact that said corporation had no funds available with which to pay fees and expenses represented by said George H. McKaig as necessary to effect said sale, the proposal of said George H. McKaig be accepted and adopted; that a resolution was adopted wherein after reciting in the preamble thereof the desire of said corporation plaintiff and cross-defendant to sell all of the bonds of said Provident Irrigation District owned by it, and the lack of money to pay for services and expenses incidental to said contemplated sale, said board resolved to accept said offer of said George H. McKaig to purchase all of the bonds of

said Provident Irrigation District owned by said corporation plaintiff and cross-defendant at the price of 15 per cent of the par value of said bonds as set forth in said written memorandum from said George H. McKaig dated September 12, 1939, subject to approval thereof by the stockholders of said corporation plaintiff and cross-defendant; and further resolved that all bonds of said district owned and held by said corporation should be deposited by the secretary thereof with Pacific National Bank of San Francisco with instructions to said bank to accept as full payment therefor a sum equivalent to 15 per cent of the par value thereof; otherwise to return all of said bonds to said corporation at the expiration of four months from the date on which the same would be deposited with said bank.

That thereupon the said George H. McKaig was recalled to the room at which said meeting of said Board of Directors was being held and was advised of the unanimous action of said Board of Directors in the acceptance of his said offer. That thereupon said George H. McKaig represented to said Board of Directors of said corporation that at least two-thirds of the outstanding bonds of said Provident Irrigation District must be deposited with the escrow agent before any application to said Reconstruction Finance Corporation for a loan would be given consideration by the Board of Directors of said Provident Irrigation District, and that said corporation plaintiff and cross-defendant together with Security First National Bank of Los Angeles and the estate of Benoit have two-

thirds of said outstanding bonds of said district. That thereupon said Board of Directors agreed that a special meeting of the stockholders of said corporation would be called at a time and place to be fixed by said George H. McKaig, as president thereof, at which said resolution of said Board of Directors would be presented for the approval or rejection of said stockholders.

III.

That on the day following said meeting of said Board of Directors, to wit, September 28, 1939, said corporation plaintiff and cross-defendant, by and through its secretary, C. M. Elmquist, deposited with Pacific National Bank of San Francisco, at its office in said city and county 511 bonds of said Provident Irrigation District each of the denomination or par value of $1000.00 and aggregating the par value of $511,000.00 together with a typewritten list of the numbers of said bonds and memorandum of the coupons attached thereto, all of which were owned by said corporation plaintiff and cross-defendant; that concurrently therewith said corporation plaintiff and cross-defendant delivered to said bank a letter bearing the date September 28, 1939, referring to said bonds and wherein it was stated that said bonds were deposited for the purpose of effecting a sale thereof by said George H. McKaig for said corporation plaintiff and cross-defendant at a price equivalent to 15 per cent of the par value thereof; and further stating that if within four months from said date said George H. McKaig pays or causes to be paid to said bank for

the account of said corporation in lawful money of the United States a sum equivalent to 15 per cent of the total par value of said bonds, said bank was directed to deliver all said bonds to said George H. McKaig or his order and if the sale of all of said bonds should not be completed by said George H. McKaig, or upon his order, within said four months from said date, then said bank should forthwith return all of said bonds to said corporation plaintiff and cross-defendant.

That likewise upon said September 28, 1939, said George H. McKaig delivered to said Pacific National Bank a letter signed by him personally wherein he referred to the delivery of said 511 bonds of said Provident Irrigation District delivered to said bank on said date by said corporation plaintiff and cross-defendant with its secretary's letter of instructions of said date, and wherein said George H. McKaig instructed said Pacific National Bank to deliver said 511 bonds upon receipt of a sum equivalent to 20 per cent of the par value of said bonds, and to pay to said George H. McKaig all of said sale price over and above a sum equivalent to 15 per cent of the par value thereof which latter amount said bank was required to pay to said corporation plaintiff and cross-defendant; that said letter from said George H. McKaig, as defendant and cross-complainant is informed and believes and therefore alleges, contained a limitation of the effectiveness of said deposit or escrow for a period of four months from the date thereof similar to that contained in said letter of said date from said cor-

poration plaintiff and cross-defendant. That at the time of the delivery of said bonds to said Pacific National Bank of San Francisco and of the delivery of said letters no ratification of said resolution of the Board of Directors of said corporation plaintiff and cross-defendant had yet been obtained.

V. (Last paragraph.)

That no independent investigation was made by said defendants E. O. Kaufmann and W. G. Aldenhagen or either of them nor by any of the members of said cross-defendant Bondholders' Committee to determine whether or not said offer of said cross-defendant George H. McKaig was the best offer that could be obtained for bonds of said Provident Irrigation District, owned by said corporation plaintiff and cross-defendant and by said cross-defendants' Bondholders Committee, and that no independent judgment was exercised by any member or members of the Board of Directors of plaintiff and cross-defendant or by any member of said cross-defendants' Bondholders Committee.

VI.

That on the 18th day of October, 1939, there were outstanding and unpaid bonds of Provident Irrigation District in the aggregate sum of approximately $957,000.00 par value, together with coupons attached to such bonds, each of which was for the sum of $30.00 as the semi-annual interest on such bond, and of which coupons those bearing dates of maturity of July 1,

1931, and all subsequent dates were wholly unpaid and in default, in addition to which there were unpaid coupons of the maturity of a date prior to July 1, 1931, attached to some bonds, to-wit: approximately 432 of said bonds. That on said 18th day of October, 1939, said Provident Irrigation District, pursuant to a resolution duly and regularly adopted by its Board of Directors made an application in writing to said Reconstruction Finance Corporation for a loan of approximately $193,500.00 to enable said district to reduce and refinance its said outstanding indebtedness, which application, if granted, and if certain conditions imposed by said Reconstruction Finance Corporation and hereinafter stated were fulfilled, would provide said district with sufficient funds to pay to the holder of each outstanding and unpaid bond with all coupons maturing on or after July 1, 1931, attached, who would accept it, the sum of $200.00 or 20% of the par value of such bond; that said plan of said district to reduce and refinance its said outstanding indebtedness also involved the exclusion from said district of approximately 10,000 acres of land and the sale of an additional 11,500 acres of land or thereabouts owned by said district and, from the proceeds of said sale, to effect a compromise and payment of all liens against the land remaining within said district, including a lien of Reclamation District No. 2047 for delinquent assessments, and a lien of the Counties of Glenn and Colusa for delinquent county taxes; and also to pay from sources other than said loan from said Reconstruction Finance Corporation all expenses of said

refinancing plan and all unpaid coupons on any of said outstanding bonds that matured at any time prior to July 1, 1931, which coupons were appurtenant to approximately 432 bonds and, at $30.00 per bond, aggregated a total of approximately $12,960.00; that coupons matured prior to July 1, 1931, and unpaid and attached to bonds owned or controlled by said corporation plaintiff and cross-defendant and by said Committee cross-defendants amounted to $12,600.00 or thereabouts. That said application was granted by said Reconstruction Finance Corporation by a resolution duly adopted by its Board of Directors on December 20, 1939; that said loan was accepted by said Provident Irrigation District by a resolution of its Board of Directors on January 2, 1940; and a plan of composition of said outstanding indebtedness of said district was set forth in a resolution of the Board of Directors of said district on January 6, 1940, which plan of reorganization was substantially as hereinabove set forth.

VII.

That prior to the meeting of the Board of Directors of Provident Land Corporation on September 27, 1939, to-wit, about the latter part of August or the fore part of September, 1939, said cross-defendant George H. McKaig had learned of said plan of said Provident Irrigation District for reducing and refinancing its said outstanding bonded indebtedness and of the prospect of said Reconstruction Finance Corporation making available to said Provident Irrigation District the sum of $193,500.00 or thereabouts as described in

the next preceding paragraph, and also at the same time, of the probable conditions upon which said loan would be granted, and had also learned that the consent of the holders of at least two-thirds of said outstanding bonded indebtedness was a prerequisite to any such plan of reduction and refinancing of said district's outstanding bonded indebtedness; that at about the same time, said George H. McKaig knew that said corporation plaintiff and cross-defendant and said Bondholders' Protective Committee of Provident Irrigation District owned and controlled at least $511,000.00 of said bonds, and that the estate of L. M. Benoit, deceased, owned $106,000.00 of said bonds and would consent to said plan, and that said Security-First National Bank of Los Angeles, as trustee of the last will and testament of Thomas Earley, deceased, and as trustee of the last will and testament of one Shettler, deceased, would probably sell $61,000.00 of said bonds for $9150.00 which sum the said George H. McKaig knew could be made available for the purchase thereof, thereby assuring the consent of more than two-thirds of said outstanding bonds.

VIII.

Cross-complainant is informed and believes and upon such information and belief alleges, that on said 27th day of September, 1939, said defendants W. G. Aldenhagen and E. O. Kaufmann, the directors of said corporation plaintiff and cross-defendant, other than said George H. McKaig, knew of the prospect of said plan for the reduction and refinancing of the

bonded indebtedness of said Provident Irrigation District and of the prospect of the holder of each outstanding bond receiving thereby 20% of the par value of each such bond and, in addition thereto, the sum of $30.00 for each coupon appurtenant to such bond which was unpaid and which matured prior to July 1, 1931, and knew of the falsity of the representations of said George H. McKaig as to the expense and time necessary to effect such plan of reduction and refinancing of the indebtedness of said Provident Irrigation District as described in Paragraph VI hereof, and each of said defendants connived and conspired with said George H. McKaig to give him, said George H. McKaig, an opportunity to make a profit represented by the difference between 15% and 20% of the par value of bonds of said district of the aggregate face value of $511,000.00 owned by said corporation plaintiff and cross-defendant and other bonds of the aggregate value of $87,000.00 owned or controlled by said committee cross-defendants and also to give said George H. McKaig an opportunity to detach from said bonds and to collect and retain for himself the sum of approximately $12,600.00 representing $30.00 on each coupon appurtenant to 420 bonds or thereabouts of said 598 bonds of said district.

XI.

That by and through said false and fraudulent representations of cross-defendant George H. McKaig and the connivance and conspiracy of cross-defendants W. C. Aldenhagen and E. O. Kaufmann with said

George H. McKaig, said corporation plaintiff and cross-defendant has purportedly sold to said George H. McKaig all of its property, to wit: 511 bonds of said Provident Irrigation District of the par value of $1000.00 each for an aggregate sum of $76,650.00, whereas said property could have been sold to Reconstruction Finance Corporation, pursuant to said plan for refinancing said bonded indebtedness of said Provident Irrigation District, for $102,200.00; by and through said false and fraudulent representations and said fraudulent conduct of said cross-defendant George H. McKaig approximately eighty-seven (87) other bonds of said Provident Irrigation District of the par value of $1000.00 each have been sold to said cross-defendant George H. McKaig by said committee cross-defendants or by the holders thereof who had obtained redelivery thereof by the direction or consent of said committee cross-defendants after having theretofore delivered said bonds to said committee for an aggregate sum of $16,050.00, whereas said bonds could have been sold to Reconstruction Refinance Corporation pursuant to said plan for $17,400.00. That by his said contract of May 7, 1936, defendant and cross-complainant has thereby sustained a loss of $30,900.00; that said cross-defendant George H. McKaig has collected and retained for himself, the sum of approximately $12,600.00 representing the amount paid by Provident Irrigation District, as a part of its said plan of refinancing, for coupons of 420 of its bonds which matured before July 1, 1931, of which one-quarter or $3150.00 is payable to defendant

and cross-complainant pursuant to said contract of May 7, 1936, and the balance, to wit, $9450.00 is payable to stockholders of said corporation plaintiff and cross-defendant and depositors of bonds of said Provident Irrigation District with cross-defendants' said committee.

That by reason thereof defendant and cross-complainant has sustained a detriment and loss in the sum of $25,550.00 on said 511 bonds of said Provident Irrigation District so putatively sold to said cross-defendant George H. McKaig and of the additional sum of $3150.00 as one-quarter of the proceeds of said coupons of said bonds for which said district paid approximately $12,600.00, and the further sum of $4350.00 as one-quarter of the sum of $17,400.00 which was paid by said Reconstruction Finance Corporation for bonds of said Provident Irrigation District other than and in addition to said 511 bonds owned by said corporation plaintiff and cross-defendant but which were in the possession and under the control of said committee cross-defendants, and the former owners of which had been represented by defendant and cross-complainant in the litigation conducted by him pursuant to his said contract of May 7, 1936.

That on September 16, 1940, said Reconstruction Finance Corporation purchased the said 511 bonds from said Provident Irrigation District plaintiff and cross-defendant and concurrently therewith paid therefor the sum of $102,200.00; that on said date said Reconstruction Finance Corporation purchased said 87

bonds from said committee cross-defendants and other owners represented in said litigation by defendant and cross-complainant and concurrently therewith paid therefor the sum of $17,400.00; that upon said date one-quarter of the aggregate of said sums, to wit, the sum of $29,900.00 became payable to defendant and cross-complainant and would have been paid to him except for said fraudulent conduct of cross-defendant George H. McKaig. That on or about said date coupons formerly appurtenant to approximately 420 of said bonds, which coupons matured prior to July 1, 1931, which coupons had been detached from said bonds by said cross-defendant George H. McKaig as hereinabove alleged, were delivered to said Provident Irrigation District or to its agent Bank of America by said cross-defendant George H. McKaig, and concurrently therewith said George H. McKaig received said sum of $12,600.00 or thereabouts as aforesaid.

Second Amendment to Cross-Complaint.

Now comes Louis Bartlett, cross-complainant in the above-entitled action, and amends his cross-complaint by adding to each cause of action thereof as paragraph XII thereof the following:

XII.

Cross-complainant alleges that on September 16, 1940, $102,200, as 20% of the par value of 511 bonds of Provident Irrigation District owned by said corporation plaintiff and cross-defendant became and was payable to it pursuant to the terms of the composition with the creditors of Provident Irrigation District,

and said sum was then paid to said Provident Land Corporation or to an agency thereof for its account; that on or about said date, in addition thereto, the sum of $12,600.00 or thereabouts, as the proceeds of coupons bearing date of January 1, 1931, appurtenant to 430 or thereabouts of said bonds of said Provident Irrigation District owned by said corporation plaintiff and cross-defendant also became and was payable to it pursuant to said reorganization and refinancing of said District and composition with its creditors, and the whole thereof would have been paid to said corporation plaintiff and cross-defendant had not said corporation fraudulently permitted said cross-defendant George H. McKaig, its president and one of its directors, to receive and collect the same, which sum as cross-complainant is informed and believes and upon such information and belief alleges, said cross-defendant George McKaig did receive and collect as the pretended and purported owner or optionee for the purchase of approximately 430 of said bonds to each of which one of said coupons was appurtenant; that on or about September 16, 1940, in addition thereto, pursuant to said plan of composition with creditors of Provident Irrigation District, the sum of $17,400.00 was received by George H. McKaig, the same being 20% of the par value of other bonds of said district owned or controlled by Provident Land Corporation and Bondholders' Proective Committee of Provident Irrigation District, subsequently to May 7, 1936, which benefited from the efforts of cross-complainant under his said contract of employment and were included in actions brought by cross-complainant thereunder; that

the aggregate of said three sums so paid or payable to all said cross-defendants was and is the sum of $132, 200.00 or thereabouts; that twenty-five per cent (25%) thereof, to wit, $33,050.00 became and was payable to cross-complainant on said September 16, 1940, in accordance with the terms of said contract referred to in paragraph VII of the first cause of action of said cross-complaint; that no part of said sum of $33,050.00 (inadvertently and incorrectly stated as $33,042.50 in paragraph X of the first cause of action) has ever been paid to cross-complainant, and the whole thereof is and has been unpaid and payable to cross-complainant at all times since September 16, 1940, together with interest thereon at the rate of seven per cent (7%) per annum from said date.

For a third and separate cause of action against cross-defendants, cross-complainant alleges:

I.

That cross-complainant incorporates by reference each and all of the allegations contained in paragraphs I to V inclusive of the first cause of action and prays that the same be deemed a part hereof.

II.

That heretofore within two years immediately preceding the commencement of this action cross-defendants became indebted to cross-complainant in the sum of $33,050.00 as and for the reasonable value of work and labor, to wit, legal services performed and rendered by cross-complainant to and on behalf of cross-defendants at their special instance and request for

which services cross-defendants agreed to pay the reasonable value thereof, that no part of said sum has heretofore been paid to cross-complainant.

Paul A. McCarthy,
Attorney for Cross-Complainant.

State of California,
City and County of San Francisco.—ss.

Louis Bartlett, being first duly sworn, deposes and says:

That he is the cross-complainant herein; that he has read the foregoing second amendment to said cross-complaint and knows the contents thereof; that the same is true of his own knowledge, except as to those matters therein stated on information and belief, and as to those matters, that he believes it to be true.

Louis Bartlett.

Subscribed and sworn to before me this 17th day of April, 1941.

(Seal) Dorothy H. McLennan,
Notary Public in and for the City and County of San Francisco, State of California.